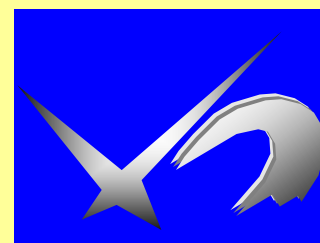
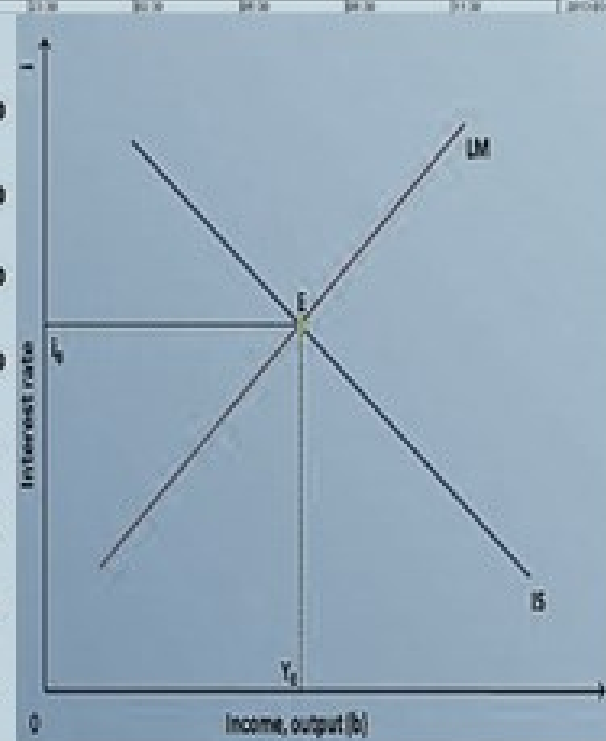
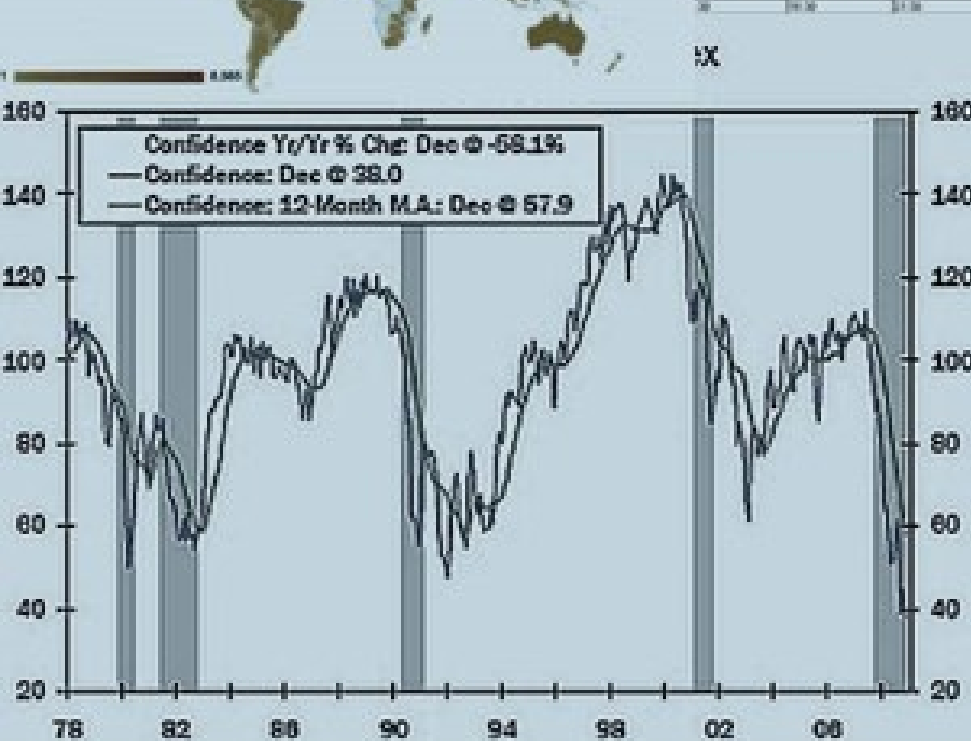


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LEGAL ISSUES CONCERNING AUDITOR - CLIENT RELATIONSHIP

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ABSTRACT: *Based on the contractual clauses and not only, the legal perspective of the relation is also very much of interest when liability occurs. The aim of this paper was to analyze the different types of legal issues concerning the auditor client relationship. As beneficiaries of the audit services, clients tend to resort to the means that aim to attract auditor's liability in case unprofessionalism or misconduct is of reasonable presumption from client's perspective. Moreover, the auditor can be the subject of different type of liability, enforced by the state, the criminal liability, as opposed to the civil liability that could be enforced by the client. On the other hand, the natural reaction of the auditor is to make use of legal provisions and clauses meant to protect himself by limiting liability. Therefore, almost every aspect of the auditor-client relationship also has a legal perspective as the very first interactions during the audit mission are predetermined by the contract signed by the two parties.*

Keywords: *legal issues, auditor, client, liability*

JEL Classification: *M42, M48, M40*

1. INTRODUCTION

Taking interest into this matter is directly generated by the increase in the appearance and recurrence of legal issues and lawsuits regarding auditors and the practice of the auditing profession. For example, a consistent change has been noticed in the United States of America where the auditing market has suffered major changes starting with the late 1980's. According to Dye (1993), the most significant change has been regarding the number of litigations having auditors as a subject which has increased significantly. One observer concluded regarding the accounting market that in 1987 "more suits have been filed against accountants in the past 15 years than in the entire history of the profession" (Mednick, 1987). Only five years later, in the United States, the total value of the lawsuits targeting auditors summed up to approximately \$30 billion (Dye, 1993). This period is relevant of taking to notice as it marks the beginning of a litigation phenomenon or practice at a much larger scale than isolated cases as it has been before that moment. Therefore, there is need for more focus on the subject as this consists in a professional risk for the auditors.

There are various situations and factors that could lead to the apparel of legal issues unfolding in the context of the ACR. One of the most important factors of influence of the ACR, independence, is directly related to auditor's legal liability (Dye, 1993). Auditors are legally responsible not only to the management, but also to shareholders and stakeholders as well. "In the absence of legal liability, one would not expect auditors to be good watch-dogs for the owners of firms" (Lee&Gu, 1998). No liability tends to translate over time, in case of many, in no responsibility.

It is of the essence of auditing profession that the auditor is responsible for providing reasonable assurance regarding the veridicity of the audited financial statements. Having no liability could affect severely the potential outcome from quality point of view. Moreover, the mixture of low balling and auditor legal liability is an effective method for avoiding the

marketplace collapse. This method involves the auditor to set up a bail bond with the owner, to be forfeited if she is found (not necessarily convicted) to have colluded with the manager (Lee&Gu, 1998).

2. JURIDICAL PERSPECTIVES AND DYNAMICS OF LEGAL LIABILITY SYSTEM

The economic ecosystem depends on the confidence that the investors can get when analyzing the opportunity of placing their funds in various entities in some economic sector. An issue on this area is linked to the fact that “the legal liability climate in some countries is causing an increasing number of large firms to avoid high-risk audit clients and even entire industries ... Without audited financial statements ... start-up businesses may not be able to generate shareholder confidence. As a result, economic growth can be stymied.” according to the statements of International Federation of Accountants (1995). The issue identified by the International Federation of Accountants is permanent over time as legal climate in some countries are continuously behind the needs of real market situation. The fact that the auditor is legally responsible for a potential audit failure translates into a indirect assurance towards outside sources, providing greater chances for the entrepreneur to finance the company from external investors at lower costs (Laux&Newman,2010). Naturally, this leads to moral dilemma for the auditor whether to put more emphasis on properly evaluating the task. The auditor’s motivation to appreciate the client varies not only on the legal obligation setting, but also on the audit fee obtainable by the businessperson: the higher the fee, the superior is the value of fetching informed around customer-type (likened to remaining uninformed and refusing the customer) and the higher is the auditor’s effort devoted to the estimation of the procedure (Laux&Newman,2010). Basically, the auditor is in need for contextual incentives, in this case of a financial nature, in order not to reject the client based on lack of information, but to make a better research regarding client's specific and needs.

Laux and Newman (2010) show that there is a direct influence between the levels of potential damage payments regarding any of the litigation components and the quality delivered in that certain audit resulting in an increase of the last along with the equilibrium audit fee. The previous relation between the three component is also empirically sustained by Seetharaman et al. (2002), Venkataraman et al. (2008) and Choi et al. (2008). Theoretically, if the context could lead to a greater anticipated damage cost on behalf of the auditor, the entrepreneur has to compensate this with an increased audit fee thus maintaining a higher interest on the auditor side and preventing an increase in the rejection rate. If shareholders anticipate a greater loss award from the auditor in case of an audit failure, then investors are willing to give the entrepreneur better financing conditions. “The entrepreneur, in turn, can use these savings to compensate the auditor for the increased liability exposure. We call this the *triangle effect*” (Laux&Newman,2010). We can conclude the fact that this relation of cascade influence tends to benefit all the parties: the auditors even if they are exposed to potentially higher damage payments also received higher audit fees, the investors perceive a higher assurance and in exchange are willing to ease the financing process and the entrepreneur also benefits from improved financing process transposing this to the need to overcompensate the auditor's fee without generating an increased cost for the company.

Legal systems across countries are not always stable and are always in constant change in the mission to adapt, and therefore, this may result in a shift in the system's strength. The previous mentioned shift could have a dual effect, increasing the potential litigation frictions on one hand and influencing the expected damage payments on the other hand. The two opposing effects, could lead, depending on which tends to manifest more, to either a decrease or an increase of the probability of rejecting a client. Laux&Newman (2010) describe the

relationship among the strength that lies in the legal liability system and rate of client rejection as being U-shaped. There is evidence in literature (Dye, 1993) that a significant part of the formal models of auditor-client interactions analyze to what extent legal liability system alterations could influence the motivation of an auditor to provide high quality audits. Laux&Newman (2010), base their relation for analysis starting from the influence that changes in legal liability system influences the efficiency of investment decisions.

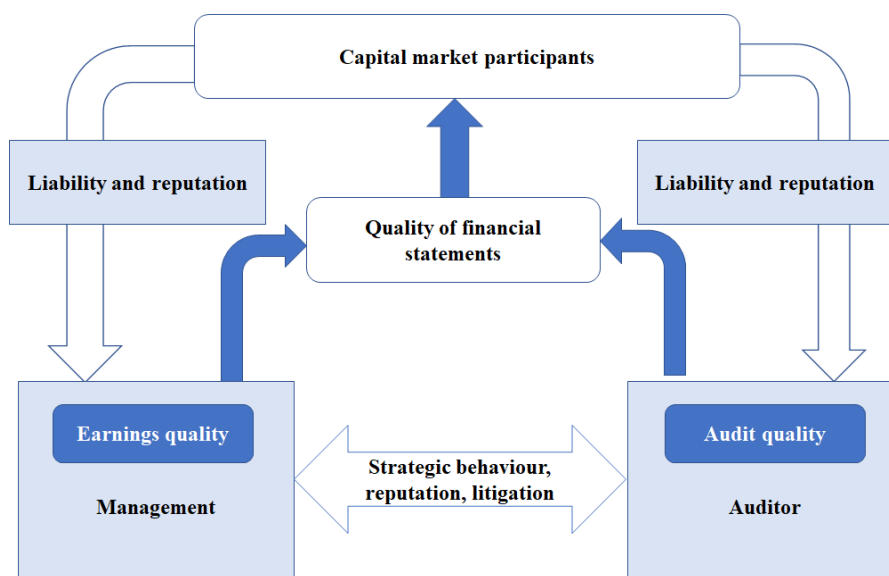
The legal liability system, as mentioned before, is a complex mechanism that is all the time in a constant change in order to adapt to market evolutions, being variously stronger or weaker over different period in time. The liability environment can be described from a three component perspective:

- the severity of the legal rule, described as the probability that the auditor is sued and found liable in case of an audit failure,
- possible damage payments from the auditor to investors,
- other legal action costs experienced by the auditor, regarded as legal action frictions, such as antagonisms costs or damage of reputation (Laux&Newman, 2010).

From a different perspective the liability system is a direct influencer of the quality of an audit. There are two indicators for the added value of an audit:

- the *informational* indicator showing the extent to what an audit provides supplementary information in order to help the entity take better decision on how to allocate resources;
- the *liability* indicator which represents the potential value of the claim that could be received by the customers of the financial reports and audit report in case of a proven audit failure (Dye, 1993).

Figure 1 Auditor Liability Dynamics



Source: Beckman&Nass, 2007

The dynamics of liability mechanism is represented by Figure 1. The ideas that can be drawn from this representation of auditor's liability is that audit quality is directly linked to the existence and extent of liability. Moreover, the input of the participants in the capital markets does influence liability. "These participants are more willing to sue when quality of financial statements is poor, whereas an auditor's reputation falls or stands with the number of claims

inflicted upon him” (Beckman&Nass, 2007). Further analyzing the Figure 1 it can be observed that audit quality is also determined by the interaction among the auditor and the client. The auditor is to some extent dependent on the management as it is one of the information provider, either it is of financial nature or linked to that.

Therefore, there is need for equilibrium as it only in the right proportion of value that liability brings the most benefits, without determining client rejection or a too bigger risk for the auditor. Neither in one of the edge situations does auditor liability reaches it's goal, but it is when the potential value is correlated with the audit company size, the audited entity and the contextual environment itself. Finally, there have to be considered the most advantageous report between liability and standards combinations, all together with measuring the auditor's potential to increase or reduce his own wealth through either merging or breaking up outside capital (Dye, 1993). Basically, there is need for evaluating also the personal interest of the auditor in the equation, resulting the fact that the most efficient rules have proven to be the ones that bring the auditor closer to respecting the standards that are applicable in the matter. Many liability regulations are proved to be comparable to regulations that correct very severe penalties on auditors who are detected to have violated the standards. When auditors can adjust their capital by increasing outside capital, they do so only if they would violate the standards out of the profit of the investment and with the capital they have an incentive to comply with the standards. When auditors can change their wealth by breaking up, it is shown that they prefer either not to break up at all or else to break up into as many firms as their wealth permits (Dye,1993). An auditor would decide to alter his wealth as a natural response of harsh liability rules that could potentially impose on him in case of standards violation. The target is to protect his wealth, the only matter that can vary is the manner in which he chooses to do so, either with the help of external capital or by devising into an optimal number of companies so that he reaches his goal.

Consequently, differences in legal systems set different requirements for the auditor and audit report, thus, developing different potential liabilities, from type and extent perspective. Regulations such as auditing, or accountings standards have dissimilar functions in financial reporting (Simunic et. al., 2017). According to previous research (Schilder&Knechel 2010) the scope of performing audits is to increase users' reliability regarding the information provided by a certain company in accordance with a set of accounting standards, whereas auditing standards aim to serve as a point of reference considering the objectives that have to be reached in an audit and the quality level in which this happens. Of course that regulating bodies have continuously tried to make the applicable regulations more uniform from country to country by developing unitary standards, so that potential exposure and liability for auditors is more predictable. Unfortunately, there are unseen and natural barriers in this process. For example, only the countries that have a comparable legal system will tend to adopt and apply ISA, even though they will bring or not slight changes to the standards (Simunic et. al., 2017). Moreover, this is of key importance because in the end the level of audit quality is a joint resultant between the characteristics of legal systems and auditing standards (Simunic et. al., 2017). There is proof in existing research that legal institutions do generate a certain influence with the downside that guidance linking a particular legal system to highest audit quality lacks (Francis&Krishnan 2002; Lee&Mande 2003; Choi et al 2008, 2009).

As mentioned before, with the unseen increase in the early 90's in litigation against auditor, leaders in domain exposed the need for supplementary research (Palmrose, 1991; Arthur Andersen et al. 1992) and the researchers did not fail to respond with various studies even until recent (Donelson et al. 2014). The scope of these studies was to reveal the causes of litigation and the needs, risks and worries of both actors. It has been stated that “most businesspeople, when questioned regarding which risk doubts them really, will frequently talk about reputation (Power, 2004). This is also applicable for auditors as in the auditing profession

reputation is of most important. Therefore, auditors have a primary need in finding and applying mechanism for limiting liability to protect not only their assets, but also their professional reputation. In case of audit-related claims, clients usually tend to appeal to lawyers in case auditor's conduct is not only of professional body competence but could consist in a lawsuit. Maksymov et. al. (2020) shows that when initiating an audit-related claim, in case attorneys step in, they take into consideration a dual perspective, both from their client's and their own professional reputation and financial potential risk, even from the early stage of litigation until a resolution is pronounced in the case.

Therefore, for a better understanding of an auditor's liability, an overall perspective upon the types of liabilities to which auditor might be exposed is needed.

➤ Types of auditor liability

During the practice of their profession, the auditor are the subject of general regulations and specific ones as well, such as accounting and auditing standards. When obliged to apply and work after the general and specific regulations, any breach of the provisions, among with the ethics code auditor must follow, could lead to liability on their behalf. Such as any other professional categories, for example architects, physicians and others, auditors are also liable (Palmrose,1991). Their liability comes at different levels and stages depending on the type of regulations and provisions that disrespected or breached. In case of professional bodies' provisions and ethics code breach, the auditor could face professional sanctions (Abdulsalam, 2020). Furthermore, in case the auditors breach regulations or contractual clauses between individual and/or organizations they could be subject of civil offences (Callen & Fang, 2017). On the other hand, the harshest case, when the sanctions could be on several levels including professional, financial and rights, is when auditors breach regulations that are directly enforced by government, thus arising disputes among entities or individuals and state that could lead to criminal offences (Palmrose,1991; Măgdaş & Fülöp, 2019). There is need for detailing each type of liability so that a proper further analysis of the protection mechanisms and liability limitation methods.

Each of the five identified categories of liability is based on the different set of regulations which, in case of knowingly or involuntary breaking, could lead to specific sanctions on behalf of the auditor (Callen & Fang, 2017). The types of liability, for better overview, are exposed in the figure below (Figure 2).

Figure 2 Categories of Auditor Liabilities



✓ Liability for Professional Misconduct - Professional Sanctions

Provided the conduct of a certain auditor is not according with the professional requirements there is case for professional liability, usually enforced by the professional bodies in which they are members. This type of liability is the least severe one in most of the cases, but it can be linked with any of the other types of liability in the situation where regulations that could lead to that have been breached. There are several sanctions that can be applied to an auditor when professional misconduct is proven (Callen & Fang, 2017; Abdulsalam, 2020). For auditors, a result of professional wrongful conduct across disciplinary procedures can result in interruption or exclusion from the profession (Mohan&Raj, 2021). Depending on the severity of the misconduct and on a relapse case or not, the professional body could also issue a written warning before moving on to the next measures as severity. The suspension consists in the prohibition to temporary practice for a specific period of time, which is automatically lifted when the term expires in case no other misconducts have occurred meanwhile. The most severe measure that a professional body could apply is the expulsion from the profession which forbids the auditor to ever practice again. This type of measure could also be a resultant of a criminal conviction of the auditor.

✓ Civil Liability

When breaching regulations or contractual provisions that are enforced between individual and/or organizations, auditors are civilly liable (Abdulsalam, 2020). The previous mentioned liability could apply also under the common law on one hand or a statutory law liability on the other hand. "Common law liability arises from negligence, breach of contract, and fraud. Statutory law liability is the obligation that comes from a certain statute or a law which is applied to society. The scope of both common law liability and statutory liability has been expanded to include certain third parties, mainly the foreseen or foreseeable users of audited financial statements" (Lessambo, 2014).

From another perspective, civil liability can be treated from another perspective and make the object of contract law provisions or law of tort regulations. Basically, the two different categories of law regulations split the auditor's liability based on the category to whom they are accountable: either to the client or to third parties (Shu, 2000; Callen & Fang, 2017). In the first case, liability towards the client based on contractual law regulations might emerge from breaching the contractual obligations (Callen & Fang, 2017; Măgdaş & Fülöp, 2019; Abdulsalam, 2020). This translates into the case where an auditor could fail to meet all that he has signed to in his engagement letter, thus providing to the shareholders occasion for litigation in order to seek remedy. The contract is one form of agreement which together with the audit engagement letter contain and define the agreed terms of the specific audit and include at least the following:

- the aim and scope of the audit of the financial report;
- the responsibilities of the auditor;
- the responsibilities of organization;
- recognition of the appropriate financial reporting framework for the realization of the financial report;
- note to the anticipated structure and content of any reports to be realized by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (Lessambo, 2014).

Secondly, when law of tort is in place auditors might face a law suit in case they do not respect obligations that concern duty of care regarding a third party (Abdulsalam,2020). Basically, they could be subject of litigation for negligence provided one extra conditions is

meet: the auditor, through is faulty conduct, has generated a certain form of loss on behalf of the third party.

✓ *Liability under Tax Law*

This minor category of liability on behalf of the auditor derives, indirectly, from certifying financial reports that are eluding the taxes owed to the state. Basically, the auditor is not the author of the fiscal crime, but auditor's client could be the potential author (Măgdaş & Fülöp, 2019). Therefore, the auditor, by certifying the financial reports, statements or account certifications that he either knows to be false or due to negligence does not properly verify the statements and financial reports, is also liable and might be charged. Even in the case where the auditor had no knowledge of the client's eluding intentions, client's carelessness would be an positive defense only in cases when a client has contributed to the auditor's failure to achieve his agreement and to report the fact (Lessambo, 2016) so the auditor is still potentially liable. He, indirectly, participates in sustaining, knowingly or not, the fiscal crime conducted by the client.

✓ *Liabilities towards Third Parties*

The entity, which is auditor's client, is not the only beneficiary of the audited financial report as many other rely on them. Based on the audited financial report and it's apparent reliability, there are several parties that might engage is various forms of collaboration with the entity. Therefore, the actions that are triggered by the interested third parties could be headed against the auditor only based on the law of torts (Lessambo, 2016). Among those tort parties there can be creditors, tax authorities, prospective shareholders, and many others. Out of the two fundaments for auditor's liability, negligence and fraud, only one of them applies regarding tort parties (Măgdaş & Fülöp, 2019). As the auditor has no binding contract with tort parties and, therefore, no obligations towards them, negligence could hardly make the case for liability towards tort parties. So, basically, the most often met case in which the auditor could be held liable towards tort parties is in case of fraud, even though the auditor has no legal binding contract with the tort parties. In any case, tort parties must prove a certain form of loss generate by the auditor's conduct. There have been established over the years, in practice several elements that a third party must make proof of in order to file a law suit against an auditor:

- the existence of a duty of care;
- the failure to provide the duty;
- the causation;
- the damage.” (Lessambo, 2016).

Only when all the above elements are all together proven by the third party the law suits is admissible against an independent auditor.

✓ *Criminal Liability*

Besides any professional specific regulations that auditors are obliged to comply with, they also have to apply and respect all laws from the country in which they operate. Throughout the program of audit, an auditor may execute several offences and be held criminally liable. “That might be the case if: (i) the auditor knowingly makes, permits, or directs another to make materially incorrect entries in a client's financial statements, (ii) fails to correct statements that are materially false or misleading when the member has such authority, and (iii) signs, permits or directs another to sign a document containing materially false or misleading information” (Lessambo, 2016). Breaching the laws that are issued by the state while they conduct their activity could draw upon them criminal persecution for acts like fraud or trading based on

inside information. There are several examples of situations that could lead to criminal liability for the auditor, without excluding others such as: “the false statement, mail fraud, aiding and abetting, conspiracy statutes” (Lessambo, 2016). Moreover, criminal prosecution could be made against auditors in case they either with full knowledge of their acts or from irresponsibility regarding their acts have issued an audit report that is unsuitable for the specific case. The result of criminal conviction could be either a criminal fine, a penalty involving deprivation of liberty or a combination of the two. Moreover, in case the criminal offences brought to the auditor are proven and they result in a conviction, the judge could decide to apply complementary penalties. These complementary penalties could consist in forfeiture of rights, prohibiting the auditor of practicing the specific professional activity in which he committed the crime for which he is convicted for (Măgdaş & Fülöp, 2019). The forfeiture of rights could, depending on the severity of the crime, be set for a shorter or longer period of time and could impact partially or totally the practice of auditing profession.

3. WAYS FOR LIMITING AUDITOR'S LIABILITY - ASSET AND PROFESSIONAL STATUS PROTECTION

As any action is followed by reaction, the auditor also, has the natural incentive of reacting to potential liability that could influence his assets and professional status. As soon as litigation started to multiply and the value of the damages in the lawsuits reached a more consistent amount as describes in the previous sub-chapter, the methods of protecting asset and professional status for the auditors started to emerge. Thoman (1996) concluded that the increase in the value of the damages leads to a reduction of the competition for clients amongst all auditors; furthermore, one of the direct choices of the auditor would be to start approaching a more conservative reporting method instead of increasing his work load, aiming for reducing his legal exposure.

There are multiple implications that start from auditor's liability and which diverge in several branches of ACR and dynamics. Previous research has shown over the years that liability impacts, for example, audit quality (Schwartz, 1997; Smith&Tidrick, 1998; Abdulsalam, 2020). Moreover, given a certain legal system literature provides proof that audit quality is also influence by auditing standards (Dye, 1993; Abdulsalam, 2020). Auditing standards enforce rules for auditor's which can serve as basis, in case of breaching the rules, for auditor liability. It is widely proven that starting from the variation of legal systems and, consequently, litigation risk to which the auditor is exposed the outcome is consistently differently from one country to another (Mednick, 1987; Arthur Andersen & Co. et al., 1992; Seetharaman et al., 2002; Francis& Wang, 2008; Choi et al., 2008, 2009; Abdulsalam,2020). This is one of the main reasons for the difficulty in providing a unitary solution for liability regulations and enforcement on one hand and, mechanisms for limiting the potential liability. Nonetheless, there are two sides to the coin: on one hand the potential litigation risk that hovers upon the auditors could be constructive motivation in providing audits of high quality, but on the other hand a too highly disproportioned cost exposure in litigation could lead even to bankruptcy for the audit companies (Honigsberg et. al., 2020).

That is why having the right proportion of liability is important. The goal is to obtain the maximum of benefits from auditor's liability without sliding to the point where the benefits start to decline to leave place for the downsides. Even though there are proven downsides of to high liability on behalf of the auditors, there is still resistance from the regulators towards the attempts meant to limit auditors' liability based on the assumption that there is direct correlation between limiting liability and lower quality in financial reporting (Louis et. al., 2019). In order to maintain a proper equilibrium of liability, as there are rules that enforce liability, there is need for mechanisms that, from the other perspective, the auditor's, limit the potential liability.

✓ *Liability for Professional Misconduct - Professional Sanctions*

The liability enforced by the professional bodies in cases of professional misconduct cannot be limited by any kind of clauses by the auditor. From the moment the auditor gains his statue of a active member of the professional body, all the rules and regulations that regard auditor's activity are applicable. Therefore, as long as the auditor is a member of the professional body and actively practices there is no other option to avoid liability for professional misconduct, but to comply with the applicable regulations and ethics code.

✓ *Civil Liability*

This type of liability is probably the most encountered in case of an auditor as it aims the compensation of the damage that was created or determined by the auditor through his actions or faulty conduct. There are several mechanisms for an auditor to attempt to protect themselves by limiting the extent of civil liability. It is natural and beneficial to maintain a balance in the situation of liability so that the equilibrium between protecting the client in case of damage or loss generate as a result of auditor's misconduct and not exceeding the proper amount of liability so that a to high risk for the auditor does not interfere with the audit quality and level of engagement, is maintained. Koch&Schunk (2009) state that in the analytic models in auditing there is proof regarding the direct influence that liability poses on the decision making process of the auditor. This decision making process includes audit efforts and decision on fees (Dye, 1993), auditor's reporting strategies (Thoman, 1996) and client-auditor acceptance (Laux& Newman, 2010). Therefore, the need for balance in the domain of auditor's civil liability is to high to be debated.

The primary method that could serve the auditors' purpose of limiting civil liability consists in contractual clauses that might be involved in the contract and commitment letter. Of course, this clauses are often subject of negotiation among the auditor and the client as they are on opposite points of view. Even though, such clauses are valid only to the extent in which they are reasonable, clauses that totally exclude liability on auditors' behalf or entirely protect the auditor against liability for guilt or fraud. Basically, this type of clauses is useful only in case their content aims to establishing a financial threshold to which liability could be enforced or exclude liability for auditor only in agreed and specific determined cases (Vera-Munoz, 2005).

Another method for limiting liability is through a professional assurance policy, which is already compulsory according to many countries' regulations. This policy implies a financial limitation of liability as in case of auditor generated damage, it will be the insurance company who will pay for the damage claim in case proven, provided the policy covers that specific type of misconduct. There is still some repercussion for the auditor as he will have to pay an increased value of the policy after the event. Moreover, in case the auditor acted in bad faith and there is proof of that, the insurance company might also try to litigate in order to avoid the obligation of covering for the damage generated by auditor's faulty conduct.

Of course that, due to the interest that this manner poses, among time there were different proposals regarding new mechanisms for limiting liability. Out of them, one of high interest and debate was to limit liability in accordance with either the size of the company or stock market capitalization (Doralt et. al., 2008). In the end, this mechanism was not considered to be suitable as it could lead to discrepancies between listed and not listed companies. To add to that, stock market capitalization is quite volatile and cannot serve as a predictable base for a liability limitation mechanism. Another highly debated approach is the one of limiting liability based on the audit fees, but this was not considered to be suitable as well considering that in order to satisfy the compensatory function of liability the bar should be set quite high (Doralt

et. al., 2008). Although this method could bring some correlation between the income and the risks to which the auditor is exposed, current practice excludes this approach as a method for limiting auditors' liability.

Mainly, the preferred method for limiting auditor's civil liability is the contractual one as this allows both the auditor and the client to meet their expectations regarding the extent of the potential liability. In principle, the risk of civil liability for auditors should be reasonably predictable in advance (Doralt et. al., 2008). This is high importance so that the auditors could fairly choose a the most efficient professional liability policy to both protect themselves and maintain a lower costs generated by civil liability risk (Doralt et. al., 2008). The main condition for liability limiting clauses is to be reasonable as the court could rule, if asked, also on the validity of such a clause, dismissing it provided it's content is far from what would be fair from both parties perspective.

✓ *Liability under Tax Law*

In case the auditor, indirectly, participates in sustaining, knowingly or not, the fiscal crime conducted by the client he is also liable. As this crime is enforced by regulations issued by the state which holds the main interest in investigating it, there is no clause or mechanism on behalf of the auditor in order to limit liability. The reason for this is that a contractual clause or any other private mechanism for limiting liability is secondary in rank when opposed to public tax law. The only manner in which the auditor could limit partially or totally liability under tax law is either to prove that it was client's conduct that determined the non-fulfilment of contractual clauses and obligation to report (Lessambo, 2016) or to manage to report the tax crime committed by the client.

✓ *Liabilities towards Third Parties*

Third-party liability occurs when interested parties trigger a lawsuit against the auditor based on the law of tort (Lessambo, 2016). The most common legal base for third-party liability is committing fraud by the auditor, but the interested party still must prove the existence of damage and the causal link between auditor's actions and the claimed damage. Obviously, the auditor has no binding contract with the third parties that could try to claim liability against the auditor for the mentioned cases. Although there is no direct contract between the auditor and the third parties, there is also no specific provision in the contract the auditor has with the client stating otherwise. So, basically, the most common and handy mechanism for the auditor in limiting liability towards third parties is to include a clause in the audit report the auditor has signed and released. The best manner to do so is to add an extra clause, after the paragraph containing the opinion, under the form of a liability disclaimer paragraph aimed against third parties in order to protect themselves from this type of liability. Also, the disclaimer paragraph mechanism could be combined, for more efficiency, with the professional assurance policy presented previously.

✓ *Criminal Liability*

Criminal liability has the same regime, as a basis, like the liability under tax law. It is the most severe form of liability for an auditor. Criminal liability for the auditor founds it's material basis in the criminal code which reunites all the norms that together represent the common law in matter of criminal law. The criminal code defines the crimes and the according sanctions. This is a normative act and it is situated from the enforcement power point of view at a higher level than any of the clauses and mechanisms that the auditor has at choice in order

to limit liability. Lessambo (2016) defines three ways of conduct on behalf of the auditor that could lead to criminal liability: directly creates false data in financial situations, knowingly fails to detect and correct them, signs, allows or directs to signing a document that has knowledge to contain false information. All of the previous mentioned conducts, as they are defined as crimes by the criminal code, a normative act at its basis, could not be limited in enforcement by private law clauses or mechanisms. Basically, the auditor has no option for limiting criminal liability other than the full compliance of the law.

There has been interest for the limitation of civil auditor's liability even at institutional level resulting in the Commission Recommendation 2008/473/EC stating the following proposals:

- “the establishment of maximum financial amounts of compensation (liability caps);
- the adoption of proportionate liability (instead of joint and several liability);
- an agreement between the auditor and his client to set a monetary cap or establish proportionate liability.” (Flores, 2011).

Even though public and governmental interest in the matter has been manifested auditors need to stay one step ahead and, in case the divergence with a client is heading towards litigation, use another protective mechanism to limit their financial damages, settling.

In the history of auditor-client litigation there have been high amounts of payments representing damages and claims based on negligence or acting in bad faith in order to gain at personal level. There are several examples of lawsuits with multi-million claims that have led to another phenomenon which is common in legal system, but in this case could be similar to liability limitation measure. This approach is called settling which implies an agreement among the two parties of a lawsuit. Two of the most well known settling cases in auditing are the 250 million dollars' settlement in 2005 made by Deloitte in the case of auditing the Fortress Re insurance company and the 229 million dollars' settlement in 2007 made by PwC in the case built against the auditors by the shareholders of Tyco. Another significant case from the amount of the damage was in 2011 when Deloitte and Touche were the target of a lawsuit arguing that due to ignorance, problems in the audited company, Taylor Bean, were not observed sooner. There are several arguments in favor of settling both in models of litigation (Lederman 1999) and audit litigation (Cushing&Gilbertson 2002), the most important advantage being related to the ability to manage risk so that the financial losses that are generated by preparing for the lawsuit are avoided, thus creating a short-term economy. Of course there are other setbacks which can be observed from the theoretical perspective in which “as individual audit litigation attorneys seek to settle cases to manage their risks, particularly the risk of reputational loss, the audit litigation profession as a whole maintains its public image and thereby its jurisdictional claim” (Maksymov et. al., 2020). The area of audit litigation exceeds in complexity the average lawsuit (Cushing&Gilbertson 2002; McCracken 2003; Guthrie 2004; Donelson et al. 2014) having a multitude of precedents in common law for example (Maksymov&Nelson 2017). There are several other aspects that differentiate the area of audit litigation from other litigation areas such as:

- the high number of legal claims that could exceed the professional insurance policy limit (Donelson et al. 2014; Peterson 2017);
- the potential high impact of such litigation that has prior led to demise of two of the largest auditing companies (Laventhol& Horwath and Arthur Andersen) having as a direct effect the increase in market share and control of the other major auditing companies;
- the existence and applicability of auditing professional standards and specific documentation to support it (Maksymov et. al., 2020).

Audit litigation attorneys have sufficient incentives to argue in favor of settling provided the fact that prolonged litigation could also affect audit company's professional

reputation. There are several reasons that motivate attorneys in making settling their first option as compared to litigation. Some of the reasons are specific to audit litigation area and consist in:

- attorneys generally perceive trial outcomes to have an element of surprise dreaded by both attorneys and their clients;
- audit litigation tends to involve particularly high claim amounts and litigation expenses on each side, which may jeopardize audit firms' solvency (Peterson, 2017) and make the litigants truly dread the potential for the unpleasant surprises discussed above;
- the outcomes of trials are publicly available and widely covered by the press, whereas details of settlements usually are not (Peterson, 2017; Maksymov et. al., 2020).

Based on the above reasons it can be concluded that both auditors and attorneys have to gain by leaving the trial as a last resort and primary opting for settlements. On one hand, attorneys provide to auditors a middle resolution, the settlement, which from auditors' and external perspective could be considered as a form of win, thus contributing to the public image of the attorneys. On the other hand, for the auditors and the auditing company, going to trial has a variable amount of unpredictability that could lead to prolonged trial expenses and higher damages which in the end might put at risk the very future existence of the audit company. Basically, as long as it is based on solid arguments and fair and reasonable positions, settling appears to be the best choice for both of the two parties that are headed for a lawsuit, the auditor and the client.

4. CONCLUSIONS

In the history of auditor-client litigation there have been high amounts of payments representing damages and claims based on negligence or acting in bad faith in order to gain at personal level. There are several examples of lawsuits with multi-million claims that have led to another phenomenon which is common in legal system, but in this case could be similar to liability limitation measure. This approach is called settling which implies an agreement among the two parties of a lawsuits. Two of the most well known settling cases in auditing are the 250 million dollars' settlement in 2005 made by Deloitte in the case of auditing the Fortress Re insurance company and the 229 million dollars settlement in 2007 made by PwC in the case built against the auditors by the shareholders of Tyco. Of course there are other setbacks which can be observed from the theoretical perspective in which "as individual audit litigation attorneys seek to settle cases to manage their risks, particularly the risk of reputational loss, the audit litigation profession as a whole maintains its public image and thereby its jurisdictional claim" (Maksymov et. al., 2020).

Based on the above reasons it can be concluded that both auditors and attorneys have to gain by leaving the trial as a last resort and primary opting for settlements. On one hand, attorneys provide to auditors a middle resolution, the settlement, which from auditors' and external perspective could be considered as a form of win, thus contributing to the public image of the attorneys. On the other hand, for the auditors and the auditing company, going to trial has a variable amount of unpredictability that could lead to prolonged trial expenses and higher damages which in the end might put at risk the very future existence of the audit company. Basically, as long as it is based on solid arguments and fair and reasonable positions, settling appears to be the best choice for both of the two parties that are headed for a lawsuit, the auditor and the client.

In all of the five analyzed types of liability on auditor's behalf (liability for professional misconduct, civil liability, liability under tax law, liability towards third parties and criminal

liability) there is need for equity and proportion so that the advantages previously mentioned, brought by adequate liability could bring, do not generate bigger disadvantages by disrupting the balance between auditor and client. Having regulations for the liability part it is only natural that there is a need for mechanisms allowing auditors to limit liability. Criminal liability and liability under tax law to a certain extent, are the only ones that, due to the enforcing power of authorities is involved, can not be the subject of liability limiting mechanisms. The type of liability where the client is opposite to the auditor is the civil liability, while stakeholders could be reimbursed in case of audit failure through the means of liability towards third parties. Even if auditors chose to make use of contractual clauses, professional assurance policies or disclaimer paragraph as liability limiting mechanisms it is important for the balance of auditor-client relationship that such case of unbalanced liability are properly identified and adjusted. In case the conflict between auditor and client turns into a lawsuit, settling has proven to be most effective for both parties, from professional and financial perspective.

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THE IMPACT OF THE COVID-19 PANDEMIC ON EU-27 NEET YOUNG PEOPLE

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ABSTRACT: *The health crisis and the economic one, generated by the first mentioned, have mostly affected youth aged 15 to 34. In the EU-27, 1.547 million young people aged 15 to 24 and another 990 thousand aged 25 to 29 lost their jobs between the fourth quarter of 2019 and the second quarter of 2020. The NEET rate (the share of unemployed youth in the labor market, nor in education and training, out of the total youth population) is a relatively new indicator that has gained increasing importance in the last two decades both in the approaches of international organizations and in the media. Recently, it has seen significant increase due to the Covid-19 crisis. The high rates of NEET youth represent a major challenge for every country, not only because of the risks of the "scarring effect", but also because of the negative effects of these statuses on future labor market outcomes for the individual, and the community and society in which they live. Assessing the economic and social consequences of NEET statutes plays an important role in developing policies for young people and in taking measures to increase their integration into the labor market and to encourage them to remain in education or training systems. This paper presents a brief analysis of the structure, educational and gender composition of NEET groups, in the period preceding the health crisis and under its impact.*

Keywords: *youth, NEET rate, youth unemployment, youth employment, crisis, impact*

JEL Classification: *I24, J13, J21, J64, J89*

1. INTRODUCTION

Young people aged 15 to 29 face the fact that they are living in an era of complete globalization and will have to cope with the responsibility of an aged population, in addition to the traditional challenges of stepping into adulthood.

According to Eurostat statistics at the European Union level, in 2021, only 62.9% of young people were employed, this being one of the lowest figures ever recorded by Eurostat. In Romania, in the same year, only 54.9% of young people aged 20 to 29 were employed.

In 2021, only 47.4% of the young people aged 15 to 29 were professionally employed. Unemployment among youth under the age of 25 had high values, standing at 16.6% in 2021, increasing by 1.5 pp compared to 2019, and for those aged 25 to 29 the unemployment rate was 9.8% with 0.7 pp over the value recorded in 2019.

According to the latest Eurostat estimates, in 2021, the percentage of youth in EU-27 who are not professionally employed, nor engaged in education or training reached 10.8% of the population aged 15 to 24 and 17.3% of the population aged 25 to 29. Like the unemployment rate, the share of young NEETs varies significantly from one Member State to another: from 5.5% in the Netherlands to 23.1% in Italy and to 20.3% in Romania, for young people aged 15 to 29 years old.

The health crisis and the economic crisis, implicitly generated by the first one, have generated many challenges that young people have to face. Furthermore, the transition from school to employment will be more difficult for the new generation when entering the labor market, as it will be in competition with an increasing number of people who are already looking for a job, for a decreasing number of positions, at least in the short term.

2. THE NEET YOUTH AND THE COVID-19 PANDEMIC

According to the definition provided by the International Labor Organization (ILO) in 2020, a person can be classified as NEET if they meet the following two criteria:

- 1) not employed or inactive in the labor market;
- 2) did not participate in any training or skills development program four weeks before the survey.

The NEET concept has made it possible to raise awareness around the number of young people who have been discouraged or gave up any job search, as well as around the inactive people who may or may not have wanted to work, recognizing the difficulties they have faced and the need for specific actions. Given the importance and size of this category of population, the European Commission has developed indicators and a specific methodology for collecting data and calculating the number of NEETs in Europe since 2010.

The methodology created by the European Commission uses the International Standard Classification of Education (ISCED) to place young people of different age groups on education levels.

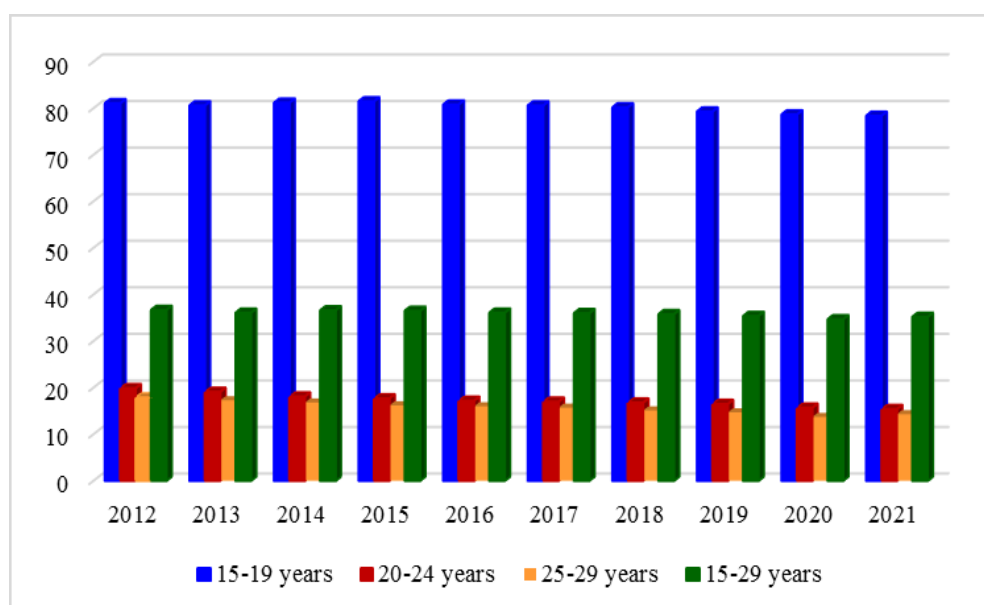
Among the most relevant risk factors for young NEET during the pandemic, we can list: the health restrictions, the migration context, the low level of education, the low income of the households, the teenagers whose parents were unemployed, the teenagers whose parents have had a low level of education, the teenagers with divorced parents.

A special category of NEET is the youth living in remote areas. They have a 1.5 times higher NEET risk than young people living in medium and large cities. They are also much more at risk of social marginalization than those in urban areas. NEET youth in rural areas face additional challenges compared to those in urban areas, due to: i) lack of adequate infrastructure, ii) high dropout rates, iii) high unemployment rates and, last but not least, iv) the process of depopulation caused by the migration of young people to rural areas (Mujčinović, et al. 2021; Simões, et al. 2021).

In order to increase the relevance of the analysis, but also to ease the identification of certain links between its partial conclusions, three areas of interest were taken into account: the degree of graduation of different levels of education, the percentage of employment, the geographical, socio-economic and age group characteristics.

The analysis of the diagrams in Figures 1 and 2 shows that NEET rates tend to remain low for the 15 to 19 age group, as most of them are still actively enrolled in education.

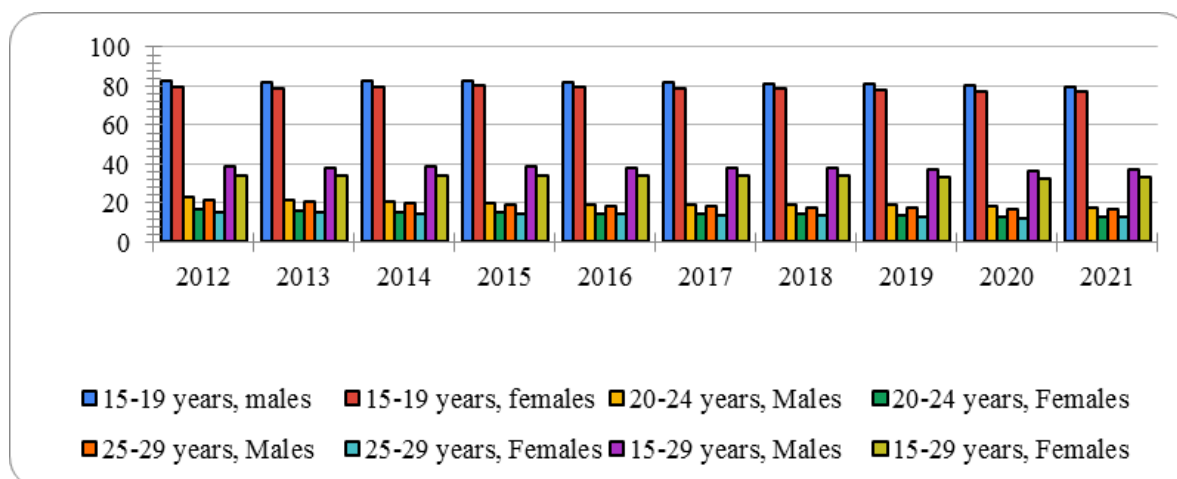
Figure 1 The evolution of primary and secondary school graduation in the EU-27, of young NEET, by age groups



Source: Eurostat statistics, *Young people by educational attainment level, sex and age, ISCED 0-2*, <https://appsso.eurostat.ec.europa.eu>

However, NEET rates are constantly increasing for each age group, so those aged 25 to 29 are the most affected (Figure 2).

Figure 2 The evolution of high school and post-high school graduation in the EU-27 of young NEET by age group



Source: Eurostat Statistics, *Young people by educational attainment level, sex and age, ISCED 3-4*, <https://appsso.eurostat.ec.europa.eu>

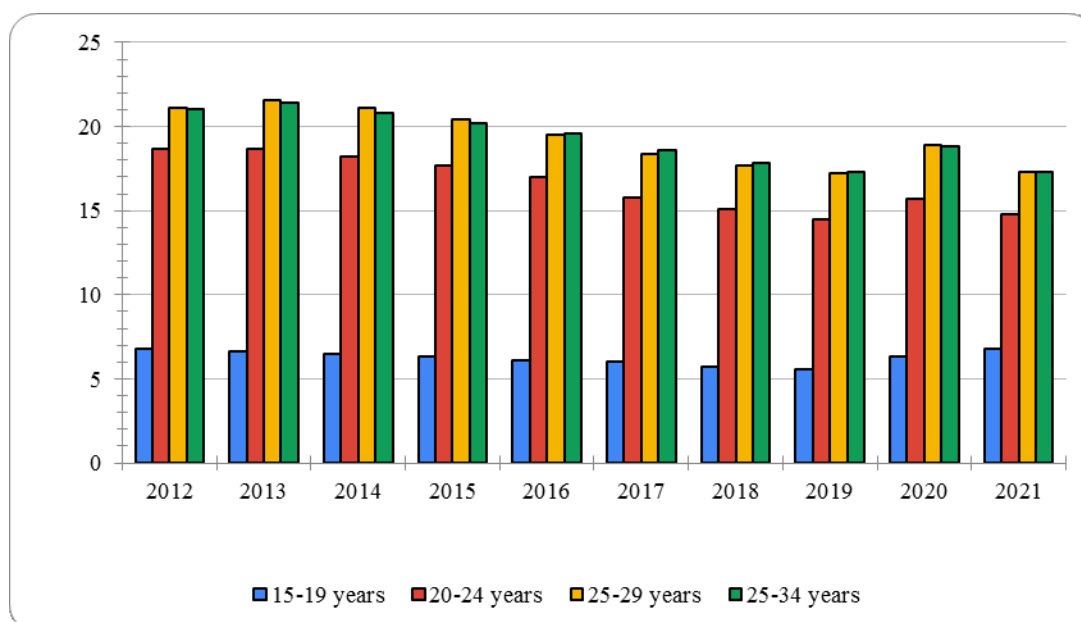
Another characteristic of young NEET is the fact that women, unlike men, have lower graduation rates in all 4-age segments, the biggest discrepancy of about 5 pp being registered in the age segment 20 to 24 years.

From the analysis of Eurostat statistics, it can be said that there is a number of factors that can determine this difference between genders, among which the following can be mentioned:

- conventions or social pressures, which tend to give more importance to the role of women in the family and the role of men at the workplace;
- career counseling, which can strengthen gender segregation and lead women to a relatively narrow range of occupations;
- labor market issues, such as: employers who prefer to hire young men at the expense of young women, young women who face difficulties in assimilating back to work after giving birth, the predisposition of young women to have poorly paid jobs, or precarious jobs.

For the period 2020-2021, Eurostat statistics indicate that there is an increase in the NEET rate in all age groups (Figure 3).

Figure 3 The evolution of the NEET rate in the EU-27, by age groups



Source: Eurostat Statistics, *Young people neither in employment nor in education and training by sex, age and labour status (NEET rates)*, <https://ec.europa.eu/eurostat>

Moreover, several international studies have indicated that the place of origin was one of the most important factors that differentiated and accentuated NEET trajectories during the pandemic and that they were more common in rural areas (Braziene, 2021).

When describing the last 3 years using the size and structure of this vulnerable group of young people by varying the NEET rate, the following reference ranges can be identified: 2019 versus 2020 = between + 0.7% and + 1.7%, and 2020 versus 2021 = between + 0.5% and -1.6%.

The NEETs are young people at the risk of poverty, social exclusion and mental health problems. Those who were already in this situation at the beginning of the pandemic were among the most vulnerable to the effects of travel restrictions, which took them even further away from work, either near their home or in other geographical locations. In addition, the opportunities for education and vocational training for young people were limited during the pandemic.

At EU-27 level the number of NEET young people aged 15 to 29 has risen to around 10 million in 2021 from 9.1 million in 2019 (to 13.1% of the youth population from 12.5%).

The impact of the health crisis on the youth labor market was strongest in 2020, when there was a decrease in the employment rate of about 2-3pp, regardless of the level of education

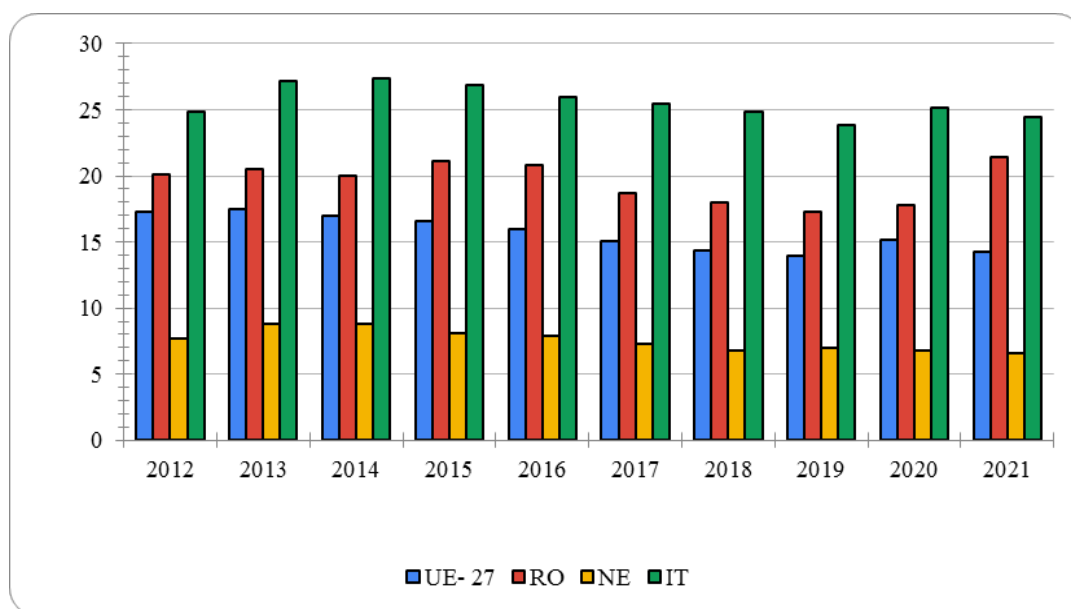
completed. This rate will start to increase in 2021, but only by about 1pp, and may follow the same positive trend in the coming years only if certain conditions are met: total restrictions liftoff, the return to the same pace of growth and the relaunch of support programs for the disadvantaged population categories. All these elements have diminished the chances of NEET young people entering the labor market.

The analysis of statistics over various periods of time, regardless of the economic situation, indicates that higher rates of NEET young people, aged 15 to 29, can be found especially among young people with a lower level of education.

Because of the pandemic, the total share of NEET increased in 2020 and registered slight reductions in 2021. The lack of data on the evolution of the number of NEET on the subgroups of this cluster does not allow the quantification of the impact of the pandemic on this vulnerable group and especially of the degree of insertion on the labor market. The aggregate data already available indicates that the NEET population structure changed during 2020 and 2021. Most likely the new NEET in 2020 were, as in the 2008-2009 crisis, primarily short-term unemployed youth.

The comparative analysis of the evolution of the NEET rate in Romania and the EU-27, highlights the fact that our country was below the EU-27 average for all levels of education, both in general and by age groups. Moreover, unlike other Member States, in 2021 Romania continued its decline on this indicator, instead of following an upward trend, even weakly positive, as other countries that registered in 2020 a high level of NEET rate (e.g. Italy) (Figure 4).

Figure 4 The evolution of the NEET rate for young people aged between 15 and 34, in Romania, EU-27, Italy and the Netherlands



Source: Eurostat Statistics, *Young people neither in employment nor in education and training by sex, age and labor status (NEET rates)*, <https://ec.europa.eu/eurostat>

The NEET rate for the 15 to 34 age group at EU-27 level in 2020 was 15.2%, higher than in the previous year by about 1pp, but returned to the value from 2019 until the end of 2021 (Figure 4). However, it is interesting to note that the value of the 2020 pandemic year is not the highest in the last decade, a sign that the inclusion and training strategies for the labor market of young people in the NEET category that have been implemented at Community level

have had a positive impact. There is a negative difference of 2.3pp between the value from 2020 and the one from 2013 (the highest in the analyzed period).

The Netherlands recorded during the pandemic the lowest level of NEET rate, of only 6.8% for young people aged 15 to 34. It also managed to continue its positive path in 2021 on this indicator, even if not substantially, to the value of 6.6%, thus following the general Community trajectory (Figure 4).

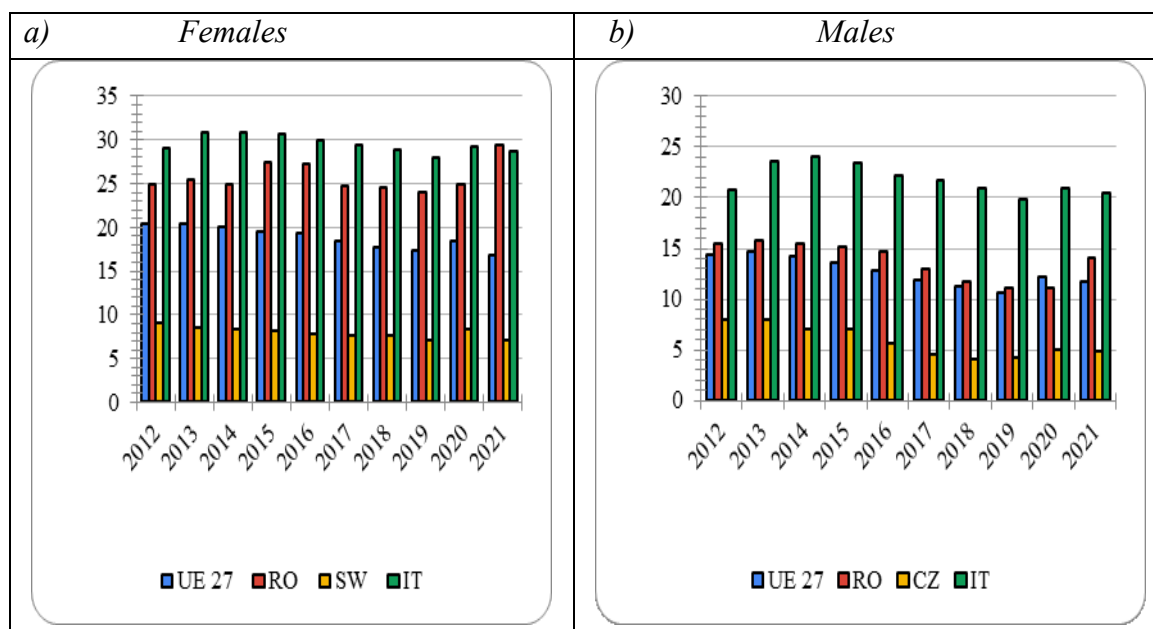
As for the last ranked, Italy, it has a route relatively parallel to the EU-27 average on the NEET rate indicator, but it is above the Community trajectory in the last decade by about 10 pp (Figure 4).

The NEET rate gap between Romania and the EU-27 is 3 to 4 pp. If in 2021, many Member States saw a slight reduction in this indicator, in Romania the NEET rate continued to increase by about 4pp, which brought it close to the level of 2015. This trend is different than most EU countries except Latvia, Luxembourg, Norway, where the decline was about 1 pp.

The analysis of the histograms in Figure 5 indicates that both at Community level and in each country, the percentage of NEET women is significantly higher than that of men (approximately 6 pp, annual average, considering the period 2012-2021) (Figure 5 a).

The socio-cultural climate, vocational counseling and the specificity of the labor market in each of the EU-27 Member States also generate these differences. If we analyze the impact of the Covid-19 pandemic on the gap between the NEET rate among young women and men, it results that the difference between 2019 and 2020 is only of 1.1pp in women and 1.5pp in men (Figure 5a and 5b).

Figure 5 The evolution of the NEET rate for young people aged 15 to 34, by gender



Source: Eurostat Statistics, *Young people neither in employment nor in education and training (NEET rates)*, <https://ec.europa.eu/eurostat>

In the case of women, Sweden registered the lowest level of the youth NEET rate during the pandemic, 8.3% in 2020 and 7.1% in 2021. This result is not accidental, because Sweden ranked first in 2017 in terms of policies and measures for promoting women and women raising children. Also, this country has one of the most generous paid parental leave policies globally (Garcia, 2017). At the same time, it actively promotes gender equality in its education system and is one of the countries with the most educated population of women globally

(approximately 58% of women have completed some form of tertiary education) (Eurostat statistics).

When talking about men, the lowest level of NEET youth was recorded in the Czech Republic (5% in 2020, 7pp below the EU-27 average). One of the main reasons for the low number of NEET young men in the Czech Republic is that employment rates among women with children are low and maternal leave is long.

The highest level of NEET rate, both among young women and men, is in Italy (Figure 5), which also recorded high unemployment rates and NEET rates during the 2008-2009 economic and financial crisis.

The relatively low degree of insertion of young people, in general and NEET in particular, is the result of multiple factors. Among those, the following can be mentioned: i) ultra-protective social measures taken by some states, ii) poor performance of some national education systems to provide skills compatible with labor market requirements; iii) matching and assigning jobs, iv) poor management of the transition from the education system to the labor market, v) lack of specific skills of candidates (OECD, 2017; Puchkov, 2021).

Each person falling under the NEET youth category entails a certain cost and, therefore, this is not only a problem for the person concerned, but also for society and economy as a whole. The economic costs of NEET are only a part of the price that Member States pay for young people in this social category.

The negative consequences of NEET status are numerous and affect not only the individual and their family, but also society as a whole. Excluding young people, both from the labor market and from education or training systems, increases the risk of social exclusion of the individual, and reduces the likelihood of re-employment.

The low level or even the lack of income among NEET young people does not allow their participation in various activities and the purchase of various consumer goods. NEET young people are people who, by their status, are excluded from the relationships / social networks created at work or in the educational environment.

The lack of a job or failure to fit into an educational or vocational system severely affects a young person, both materially and emotionally. The direct effects of NEET status are highly visible and have a crucial impact on all facets of a person's life, from social to intimate, from family to friends.

The characteristics of a young NEET are the feelings of stress, panic, anxiety, frustration, anger, nervousness. All emotional states that the young person goes through due to a low or a complete lack of income have consequences both on their own person and in their relationship with the world around them. Interpersonal relationships are threatened by the behavior of the young NEET, who can seek refuge in many harmful activities.

A special role belongs to the moral and mental state, which affects the young person who has become NEET more than the economic side. There are complexities of no use for society and the family. At the same time, the prolongation of the NEET period, which generates the poverty of an important group of the young population, can lead to deep social conflicts.

The monetary and non-monetary barriers that young NEET face on a daily basis make them more susceptible to traumatic experiences. Trauma can turn into a general and resentful dissatisfaction with society as a whole and with the government, whether national and regional / local, or even perceived as "invasive" by regional or international superstructures (e.g., European Union, IMF, World Bank, etc.).

The pandemic has had a visibly disproportionate impact on the mental well-being of youth in general and NEET in particular, compared to people in other age groups.

The risk of depression was particularly high among young unemployed / inactive people, rising from 62% in April 2020 to 66% in July 2020 and reaching 83% in March 2021. Among those employed, the risk of depression was 56% (in March 2021), and for students 65%

(in March 2021). All these values are particularly high compared to those presented in social surveys conducted before the pandemic (when the average proportion of people in the EU-27 at risk of depression was 22% in 2016) (Eurofound, 2016, 2021).

Poor mental health of young people, and especially young women, can have a negative impact on their access to the labor market.

3. CONCLUSIONS

The COVID-19 crisis has severely affected vulnerable groups around the world, with stronger negative effects on young people compared other age groups.

Based on studies and research about the structure and size of NEET youth groups carried out in the years before the pandemic, a number of intervention policies and measures have been launched at both Community and Member State level. The measures aimed to support this vulnerable group of young people in the pandemic and especially increase their degree of insertion on the labor market. Local, regional and national projects aimed to bring this group of young people into education, training and employment. These projects focused on the following areas of interest:

- i) ways to prevent school dropout,
- ii) facilitating the transition from school to work,
- iii) promoting professional insertion,
- iv) financing and initiating training courses in partnership with employers, designed to provide young people with a minimum of experience before they can be inserted professionally.

The COVID-19 pandemic has had a significant impact on young NEET in general, but particularly on those living in rural areas, with disadvantaged backgrounds or from marginalized communities (they face additional challenges).

In this context, they need to become a priority in NEET support projects and aid schemes as soon as possible.

Also, in these projects, regardless of the environment from which young NEET come, more emphasis needs to be placed on initiatives to improve mental health, because motivation plays an important role in both personal and professional development.

As young NEET face a higher risk of exclusion and tend to be more vulnerable to economic and social change, the dropout rate will also increase, as will the unemployment rate.

In order to avoid a "lost" or blocked generation, it is important that decision-makers pay particular attention to young people in the recovery phase, monitor whether the policies currently implemented are sufficient, take proper action where appropriate, and not in lastly, adopt cross-sectoral measures to integrate mental health policies into education, employment and welfare systems.

Ensuring adequate and sustainable measures, coupled with adequate funding and adapted social services, is the only chance for these young people to integrate properly with other members of society.

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THE EFFICIENCY OF TRANSPORT INFRASTRUCTURE PROJECTS IN A SUSTAINABLE DEVELOPMENT CONCEPT. THE EFFICIENCY COMPOSITE MODEL APPROACH

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ABSTRACT: *Over time, mankind has gone through various world crises, which have determined the adaptation of the systems and principles on which societies based their existence to the realities and challenges of that time. This process was achieved through the emergence of new methods of evaluating the efficiency of project planning and implementation in relation to the needs of sustainable development.*

The research aims to identify the elements and divisions that enter in the composition of a congruence coefficient (corresponding to an optimal point), which will help the efficiency of transport infrastructure projects, in the context of sustainable development, to be properly evaluated. This paper presents the synergy between the concept of efficiency and sustainable development, which has acquired forms, causalities and influences determined by the intensification of concerns regarding solutions for adapting to the effects of climate change and mitigating it and by the evolution of globalization processes.

Keywords: *sustainable development, transport infrastructure, climate change, environment, biodiversity, taxonomy.*

JEL Classification: *Q01, Q54, Q56, R42*

1. INTRODUCTION

The main objective of this research was to determine the components of a congruence coefficient, to properly evaluate the efficiency of transport infrastructure projects.

The desideratum of the concept of sustainable development is based on its three pillars, namely: economic, social and environmental, strongly expressing the need to implement a taxonomy and a global methodology for determining the economic efficiency at the level of each project in relation to absolute interdependence with environmental efficiency and society (Zaman, 2014).

Sustainable development refers to the importance of how energy, natural, informational, material, environmental and financial resources are managed, in order for future generations to have access to the same amount of resources related to the level of demand or similar alternatives, without affecting the quality of life or the integrity of the environment in which they live (Neaga, 2015).

The way in which this is achieved is currently assessed, for each project separately, by determining the degree of efficiency, based on defined or well-defined criteria.

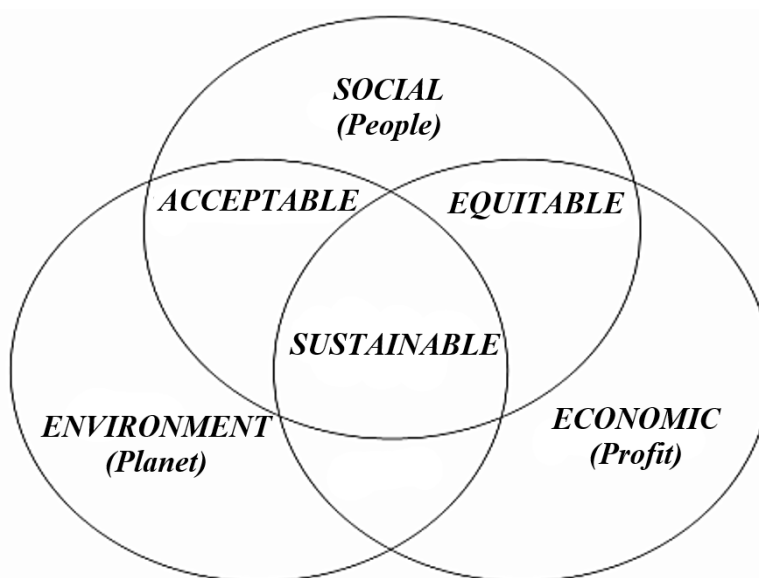
The idea of efficiency has undergone over time transformations in strict relation to the development directions established globally through summits and protocols assumed by the countries that have become active participants in the sustainability concerns of the projects.

The efficiency is a complex concept that involves identifying a balance between the pillars of sustainable development, by implementing solid principles of social equity, circular

economy, continuous adaptability to the changes of the Planet, multidisciplinary, innovation and anticipation of the needs of future generations.

The efficiency of a project is related to its durability over time, in the context of achieving a level of balance of the components that define the concept of sustainability. (Figure 1).

Figure 1. Sustainable development and the area of congruence between the three constituent pillars: social, economic, and environmental - adaptation after



Sources: UCN, 2006, *The future of Sustainability. Rethinking Environment and Development in the Twenty-first Century*, Report of IUCN

2. LITERATURE REVIEW

According to Dyllick and Hockerts, sustainable development can only be achieved when the following criteria are met simultaneously: "eco-efficiency, socio-efficiency, sufficiency and equity". All these theories are subject to their own interpretation by specialists, and to reduce the factor of variability caused by "expert-opinion" ("opinion based on the expertise and experience of the developer"), it is necessary a thorough research of all elements that can form the basis of regulations, both taxonomic on efficiency, but also on a method of unit evaluation.

Environmental protection objectives relevant to the verification of the degree of efficiency of plans or projects shall consider the following:

- environmental objectives set through existing national and European strategies, programs, plans, policies and regulations;
- the relevant aspects of environmental protection and the dynamics of changing environmental parameters;
- cooperation of policies, programs, plans, strategies, and regulations relevant to the objectives of the analyzed plan with those for the existing transport sector at national and European level.

In present time, in order to be able to properly assess the efficiency of transport infrastructure projects, it is necessary to take into account the following legislative and regulatory acts.:

- a) The Objectives set by the National Recovery and Resilience Plan (NRRP) 2021-2027

- b) The Strategy for sustainable transport for the period 2007-2013 and 2020, 2030
- c) Romania's National Strategy on Climate Change 2013 – 2020
- d) National Strategy for Sustainable Development of Romania Horizons 2013 – 2020 – 2030
- e) The national action plan 2016 - 2020 on climate change
- f) Sustainable Urban Mobility Plans or local/ regional air quality plans, 2016-2030
- g) The White Paper on Transport/ Transport White Book
- h) Europe 2020 Strategy
- i) EU Green Paper on Urban Mobility, "Towards a New Culture of Urban Mobility"
- j) EU Sustainable Development Strategy
- k) technical guidelines on the application of the "do no significant harm" principle under the Recovery and Resilience Mechanism Regulation (DNSH)

3. METHODOLOGY

From a methodological point of view, the following methods, tools and procedures were used:

- a. accumulations and outcomes from the specialized literature
- b. best practices of other countries
- c. own data processing, figures, and tables to describe conceptual relationships
- d. comparison between current and proposed methodology

The main data sources are:

- EU Parliament, 2020, *Sustainable finance – EU taxonomy, A framework to facilitate sustainable investment*
- EU Parliament, 2014, *The Core Network Corridors Progress Report*
- European Commission, 2019, *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Review of Progress on Implementation of the EU Green Infrastructure Strategy*, Bruxelles

4. RESULTS AND DISCUSSIONS

Establishing the efficiency of projects. Main theoretical and practical approaches

In order to determine the efficiency of a transport infrastructure project, several actions are carried out, depending on the implementation phase of the project. (Figure 2).

Pre-planning stage

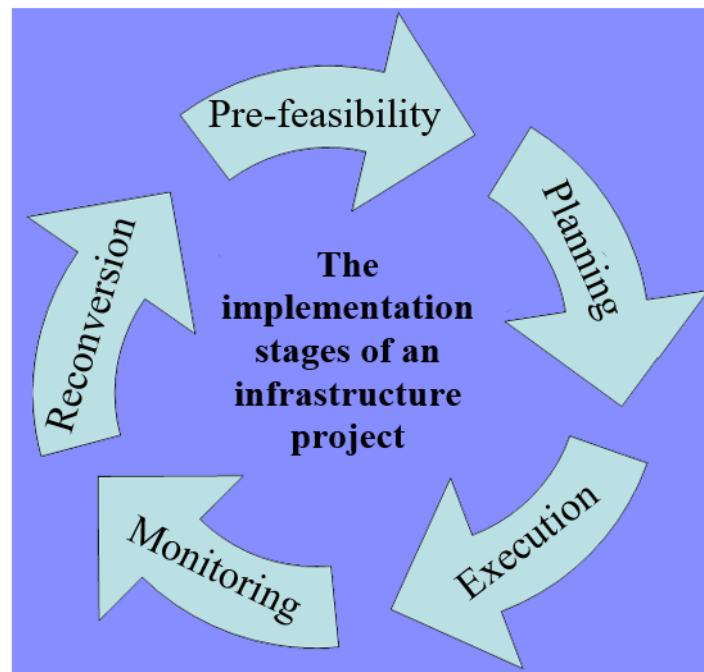
In this stage, the idea and the capacity to materialize it are analyzed based on the following aspects:

- internationally established development directions (Necessity);
- the potential for implementation at the level of a region and possible general guidelines for preparation, implementation and management (Possibility);
- constraints in carrying out the project identified based on pre-existing information about the area in which the project is to be implemented (Risks);
- complementarity or connectivity with the projects already implemented (Integration and Cumulative Impact);

- the potential for innovation and the ability to adapt to current development concepts (Sustainable Development).

This first stage does not define the physical characteristics or constituent elements of the project or plan but analyzes the applicability of the project and the area in which it is most feasible to be implemented. This removes all the general constraints already known and the approach is meant to save resources allocated to the planning process.

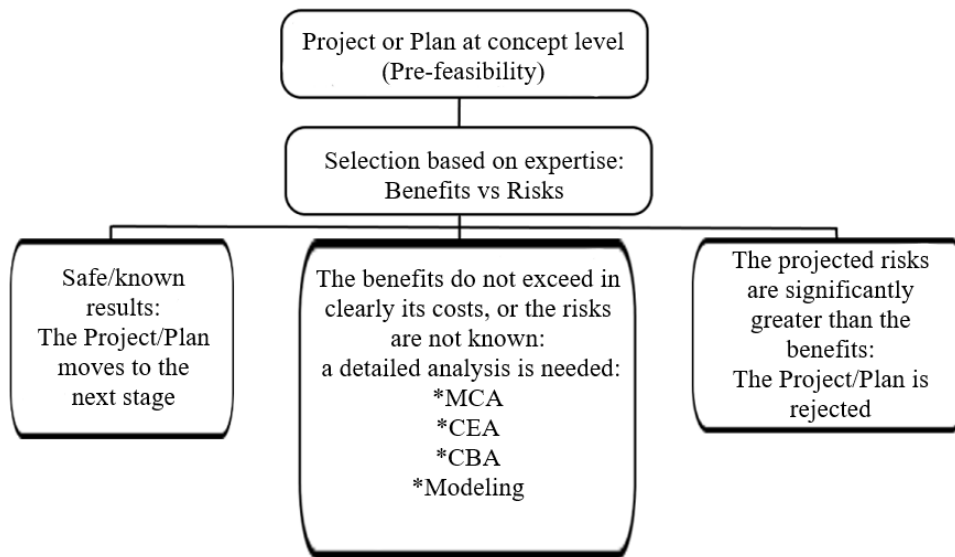
Figure 2. Life cycle of an infrastructure project



Planning stage

At this stage, an extensive detail and deepening is required for the investment holders to know in detail the benefits and risks, so that the planning stage is carried out while avoiding any blockages that may occur. This stage is carried out based on initial multicriteria analysis (MCA) studies, cost-benefit analyzes (CBA), cost-efficiency analyzes (CEA) or based on complex modeling. For projects or plans that already have a general analysis at regional level, which are classified as "safe" projects, with expected and known results, such an analysis is no longer required, although any local implementation has its own constraints and risks. For the other projects, such an evaluation is required to be able to move on to the next stages (Figure 3).

Figure 3. Stages of the project evaluation process in terms of sustainable benefits balance - risks and significant impact



The first step in verifying the efficiency of the project in the context of sustainability is to establish certain route options, also called the "long list of options".

The contoured route alternatives are subsequently compared with each other through an efficiency indicator established based on detailed studies described below.

Multicriteria analysis is a method of qualitative and quantitative assessment that integrates all relevant criteria and sub-criteria that define the interaction project - environment - economic and social implications, such as:

- environmental factors water, air, soil, biodiversity; the effects generated by the project implementation and all other elements that may generate effects on the environment are analyzed, thus defining its area of influence (elements of conservative importance affected by the project, affected protected natural sites, effect on interconnectivity between ecological sites or corridors, impact over time on environmental factors, etc.);
- elements of archaeological and cultural importance;
- projects in progress or to be implemented in the area of interest for the project and the interaction between them and the environment (transport routes and possible blockages, greenhouse gases, noise or other pollution generated by cumulative effect, etc.);
- execution technologies;
- raw materials used and waste generated by the project;
- the ability to use recyclable materials and the ability to integrate components with a shorter lifespan than the project into the concept of circular economy;
- the study on the adaptation of the project to climate change;
- the amount of greenhouse gas emissions generated by the change in land use category and the measures needed to be implemented to recover them in accordance with internationally set targets;
- the general costs associated with the execution of the project, by categories of works, not by well-defined technical solutions (at the level of preliminary analysis);
- the number of people affected by the implementation of the project through expropriations, demolition, noise, vibration, limiting their access to resources, etc.;

- other elements that may be foreseen at the time of drawing up the pre-feasibility project.

Stages of execution, exploitation and conversion

The execution stage implements the solutions adopted in the project and treats any risks that may arise during construction. At this stage, environmental experts and specialists seek to implement existing measures and effects to determine their effectiveness, by reference to the baseline and the objectives set by the regulatory and authorizing acts of the project.

In the operation / exploitation stage of the project it's important, as in the other previous stages, the activity of monitoring the effectiveness of the project, as part of the evaluation of its efficiency, carried out through the following activities:

- field trips of qualified personnel to inventory the characteristics of all species and habitats in the analyzed area;
- assessment of habitat restoration capacity and identification of crop associations in affected areas during the construction period and on newly created structures;
- assessment/evaluation of the dynamics and impact of invasive plants;
- assessment of the extent/magnitude of the impact produced by the project (through collision, mortality, noise, accidental pollution, etc.) on species of wild fauna;
- assessing the effectiveness of impact reduction measures;
- evaluation of the effectiveness of the solutions adopted for the permeability of species;
- effective verification of protection measures and implementation of new measures for unforeseeable situations.

In addition to the existing challenges resulting from the physical implementation of the project, the risk associated with the effect of obsolescence brings additional pressure to the processes of establishing its efficiency.

If a transport infrastructure project ends up being technologically worn out, it re-enters the analysis process, this time to identify possibilities for conversion or improvement, to be able to continue to meet existing standards and to be declared effective from the point of view of sustainable development.

It is obvious that to be able to develop a transport project, it is necessary to allocate sufficient time to the analyzes on its efficiency in the context of climate change, and this is done with a well-organized and complete team of specialists.

For the result of the evaluation of the efficiency level to be the best possible, it is necessary to have a system of rules and methods to ensure bidirectional collaboration at interinstitutional and personal level of all factors involved in the analysis process and those directly or indirectly affected by realization of the project.

The evaluation methods, although they are included in the normative and legislative acts, depend on the capacity of the developers/ evaluators to integrate the obtained data, to identify the risks associated with the implementation of the project in relation to the environment and to foresee the possible risks that may generate unjustified or inefficient consumption of resources.

In other words, the analysis of the efficiency of projects implies an integration of several fields, which ultimately results in a constructive solution, based on the opinions of several specialists, each of whom has a certain degree of subjectivity.

Local technological knowledge, cultural belongings, or the level of training of the experts involved in the analysis can lead to different results and levels of efficiency, which creates problems of efficient management from the point of view of the correct implementation of the measures established at global level.

If the analysis processes at the local level differ from each other, we cannot say that the notion of efficiency is a term unanimously understood and applied uniformly, thus integrating this practice of establishing the degree of efficiency into the Latin proverb "*non idem est si duo dicunt idem*" (Eng.: "it is not the same when two say the same").

5. CONCLUSIONS

The research aims to underline the necessity of a detailed analysis for each method that enters the calculation of economic, social and environmental efficiency, in order to ensure an adequate and complete approach to the evaluation process.

Based on the data used, the subcomponents of each criterion must be investigated and cumulated to identify the particularities that enter in the structure of the efficiency composite, in correlation with the European requirements.

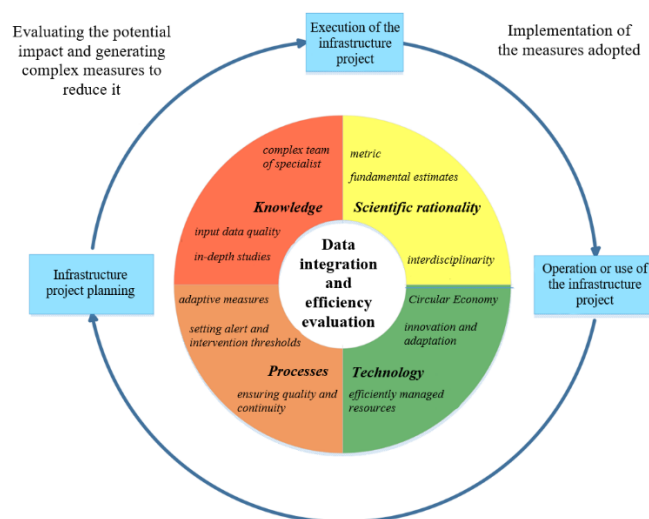
The integrated data will be merged to identify the net benefits and to quantify the usefulness of a responsible, complex and unitary management approach to the evaluation process, that maximizes the potential for using the project in relation to the three components of the principle of sustainable development.

This approach will be based on a research basis for identifying an optimal factor that include all current elements on concepts and trends about sustainability, sustainable development and the circular economy.

The proposed complex model will allow the possibility of unitary definition of efficiency of transport infrastructure projects, incorporating the multi-criteria elements of each determining factor into a single factor called efficiency composite. The efficiency composite, whose valences will also be demonstrated through a case study, will combine and adapt different evaluation methods existing at national and international level and will develop a process based on a multicriterial analysis, which offers a new holistic approach.

The objective of the proposed research is to provide a starting point in terms of a modern experience regarding environmental protection in Romania, in the context of the road infrastructure and at the same time, to serve as a decision-making tool for financing investments in Romania. (Figure 4).

Figure 4. Components of the process of defining the efficiency of an infrastructure project



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TAX OPTIMISATION

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ABSTRACT: *Multinational companies operating in several states fiscally optimise their business by “choosing and implementing the optimal (economic) solution (out of various possibilities)” . In some cases, tax optimisation takes aggressive forms with the aim of avoiding tax obligations. Aggressive tax optimisation is mainly aimed at obtaining tax advantages through cross-border intra-group arrangements, successive transactions, the fragmentation of activities among group entities and price manipulation. The DAC 6 Directive and the Multilateral Convention (MLI) as well as the latest rulings of the CJEU recommend limiting the avoidance of taxes in the state where the profit is made, and a major role in this regard is played by control institutions.*

Keywords: *tax optimisation, cross-border arrangements, fixed establishment, permanent establishment, successive intra-group transactions*

JEL Classification: *H21, H25, F53, G31, F38, L14, D23*

1. INTRODUCTION

The guidelines of international bodies (OECD, EU, CJEU) on the taxation of the economic activities of multinational companies in the state where the profit is made have materialised in recent regulations allowing tax authorities to learn about and limit the avoidance of tax payment by transferring profit to low-tax states.

The reform of the international framework on corporation tax provides for two components:

- Pillar I – the re-allocation of part of the taxing right using a calculation formula that takes into account the number of customers/users where the multinational group operates;
- Pillar II – a rate of minimum taxation for profits made by multinational groups in order to limit the transfer of the profit to low-tax areas.

In this context, these changes can influence the Romanian tax system and can generate higher revenues for the budget from corporation tax through fair payment by companies. Thus, the use of a form of profit allocation based on a formula set out in Pillars I and II is likely to automatically lead to the elimination of complex transfer pricing rules in the EU that are difficult to implement and equally difficult to demonstrate. In Romania, the transfer pricing documentation file used for reviewing related party transactions has become an inoperative formal tool, which does not offer any consistent levers for reconsidering/reinstating transactions between affiliates, as it is usually drawn up by consultants to present the business model, not to compare transactions carried out at the market price used by uncontrolled entities. In order to prepare the shift to the new arm's length tax system, it is necessary to know and explore cross-border arrangements used by multinational companies that allow not only profit outsourcing but also the outsourcing of turnover, i.e. of revenues made in Romania, which are not declared and, thus, not taxed.

These methods of analysis would eliminate the current taxation system based on complex and subjective transfer pricing rules, which are difficult to establish and demonstrate

and which create tax disputes between tax authorities and multinational groups (that benefit from considerable expert advice).

2. AGGRESSIVE TAX OPTIMISATION

Difficult conditions faced by all states and tax competition among companies, given current difficult economic conditions, bring the aggressive tax optimisation (tax elimination/reduction) employed by multinational companies into focus.

Business fragmentation through tax records and successive intra-group transactions (intra-group transactions account for 50 to 60% of commercial transactions between companies worldwide according to some EU studies) result in a 'duel' between the tax bodies of each state and the representatives of these companies – specialised consultants (lawyers, experts, consultants, etc.).

In this respect, current approaches resulting from the conduct of commercial activities through undeclared permanent/fixed establishments in Romania and the taxation of profit in the country where the 'activity' takes place become subjects for debate between authorities, consultants and cross-border industrial organisations and can constitute 'disputes' with substantial direct and negative consequences on the business model.

National laws do not provide for additional constraints in the event of a reconsideration of transactions through which tax advantages have been obtained (other than their reinstatement and the imposition of an obligation to the State). Thus, there is no deterrence or legal prevention with coercive measures, and so it has allowed tax optimisations to be employed on a large scale. Intra-group transactions are all the more obvious and widespread, to a significant degree, in states where the administrative capacity (in terms of control institutions) is low or not focused on this objective.

The provision of the necessary material and human resources to the National Agency for Fiscal Administration (NAFA) is the most important link in the approach, review, investigation, process outlining and *limitation of the adverse effects of profit outsourcing*.

The exchange of information among tax authorities should identify companies using optimisation mechanisms and schemes through which tax advantages are obtained by way of successive intra-group transactions, as well as companies using formal criteria that give the appearance of compliance with standard taxation rules in the state where they operate and make a profit.

In fact, through the implemented business models, in some cases, the payment of taxes is avoided, and the profit is outsourced to states with more advantageous taxation for companies.

The tax optimisation employed by multinational companies in their activity in Romania involves using legislative gaps as a way of avoiding taxes payable and especially of outsourcing the profit.

Legal tax optimisation within fair limits is applicable when no tax advantages are pursued at all costs. Aggressive tax optimisation aims at obtaining tax advantages (tax reduction or elimination) and involves business tax planning from the registration for tax purposes with the tax body itself, using successive intra-group transactions between related parties, which are not carried out at market price (as is the case with independent entities). In order to obtain tax advantages, these entities use transfer pricing techniques and methods, the transfer pricing documentation file precisely because of the control and dependency relationships, intra-group companies and successive transactions, which are difficult for the tax authorities to verify.

Turnover outsourcing is one of the most aggressive practices employed by multinational companies with the assistance of tax consultants and is a way for multinational companies to achieve tax optimisation for their business.

Transfer pricing refers to companies or 'structures' owned in several states that sometimes allow successive intra-group transactions which are difficult to track and tax and which are designed to obtain tax advantages as a result of exemptions, facilities and reductions in tax granted by states in certain fields.

It is possible to avoid paying taxes, as shown, thanks to the related party relationship between these companies of the multinational group performing transactions which are usually not carried out at market price (similar to independent enterprises) allowing company capitalisation, as well as distortions on the competitive market.

The tax optimisation employed uses legislative gaps and inaccuracies, a strong 'lobby' on tax regulations and laws and specialised consultancy (lawyers, experts, accountants, insolvency practitioners, tax consultants) with consultancy activity in several states allowing them to know the differences and various facilities among the various states.

The tax optimisation employed by multinational companies becomes aggressive in some cases and results in both the avoidance of corporation tax payment and the failure to collect the VAT (see Romania's VAT gap), proving the lack of administrative capacity on part of the state to collect its taxes resulting from the exploitation of material resources (mineral, energy or manufactured resources) and human resources.

The specific amount of intra-group transactions allowing the outsourcing of the profit made in Romania (the avoidance of corporation tax payment) and, last but not least, not only the non-collection of the VAT but also the reimbursement of significant VAT amounts from the state budget is unknown.

The stated goal of government objectives of achieving massive investment by attracting multinational groups is a strategic one, but the generation of budget revenues (from taxes) should equally become a top priority goal, by eliminating legislative gaps and tax inaccuracies that allow the outsourcing of profit and the avoidance of paying tax obligations for the activity carried out in Romania.

Controversy related to the declaration of the economic activity carried out in Romania by multinational companies stems in particular from the method of registration for tax purposes with the competent tax body, since the provisions of art. 49 of the Treaty on the Functioning of the European Union (TFEU) – Right of establishment entitle multinational companies to select their form of 'establishment', with the following to choose from: limited liability company (SRL) (Art. 8(37) of the Law no. 227/2015 on the Tax Code, with the subsequent amendments and additions, art. 5(2) of the Law no. 31/1990 R on trading companies, with the subsequent amendments and additions), subsidiary (Art. 42 of the Law no. 31/1990 on trading companies, with the subsequent amendments and additions) or branch (Art. 43(1) of the Law no. 31/1990 on trading companies, with the subsequent amendments and additions).

In addition to these forms of business establishment in Romania (with the assignment of a unique tax registration number by the National Trade Register Office – ONRC) under which these entities operate according to Law no. 31/1990, as republished, there are also other methods of business registration:

- A permanent establishment (Art. 8(1) of the Law no. 227/2015 on the Tax Code – the definition of a permanent establishment) – in terms of corporation tax
- A fixed establishment (Art. 11 of Regulation no. 282/2011 "in application of Article 44 of Directive 2006/112/EC" in conjunction with art. 44 of Directive 2006/112/EC on the common system of value added tax) – in terms of VAT
- A tax representative (Art. 293(1)(m) in conjunction with art. 316(61) of the Law no. 227/2015 on the Tax Code) – in terms of VAT and other obligations
- Direct registration (Art. 316(4) or (6) of the Law no. 227/2015 on the Tax Code) (for VAT only)

- A business representative office (Art. 237(3) of the Law no. 227/2015 on the Tax Code in conjunction with sub-section 88(6) of the Detailed Rules for the application of the Law no. 227/2015 on the Tax Code)
- Registration by the income payer (for income withholding tax purposes).

These forms of registration for tax purposes involve the assignment of a tax registration number (CIF) by the competent tax authority (NAFA).

Intra-group transactions carried out by multinational companies in Romania between a company (holding a unique identification code – CUI, often wholly controlled by the parent entity which is resident in another state) and the tax registration number (CIF) assigned as a non-resident entity to the parent entity in another state constitute one of the transfer pricing methods allowing the outsourcing of profit but especially of turnover (income realised) by manipulating intra-group prices (increase or decrease, according to company needs, for the avoidance of tax obligations: corporation tax and VAT).

3. THE TRANSFER PRICING DOCUMENTATION FILE

The transfer pricing documentation file (the Order of the President of NAFA no. 442/2015) (The Order of the President of ANAF no. 442/2015 on the amount of transactions, deadlines for the preparation, content and terms and conditions for requesting the transfer pricing documentation file and the procedure for the adjustment/estimate of transfer prices) and pricing methods – which determine the market value/price of related party transactions are cumbersome and formal methods because for the most part the ‘appropriate’ method results in disputes with tax authorities and controversy in which it is difficult to prove who is right.

Over time, the transfer pricing documentation file has become formal, subjective and inconclusive in respect of the prices charged using an average market margin which is difficult to calculate.

For example: for the contract-based activity (services) multinational companies use a margin of 3-5% applied to the cost of labour. Given the low cost of salaries in Romania compared to other states, the declared profit is also very low. Seeing as large consultancy companies advise these companies, the method has become standardised and, so, a ‘formal’ documentation file for the ‘market’ price is drawn up with an average margin of 3-5% for limited liability companies (owned and controlled by the parent entity). At the same time, the foreign entity also registers for purchases of equipment, manufacturing lines and moulds directly by the assignment of a tax identification number (CIF) only for VAT and VAT deduction (providing these free of charge – excluding VAT).

Specialists may notice that the depreciation of these goods in Romania is not an element of the cost price or an element of the establishment of the minimum rate of 3-5%.

Thus, the production activity as a whole carried out in Romania by these multinational companies has a very low mark-up rate for taxation, depriving the state budget of significant amounts, but especially generators of unfair competition in relation to local (Romanian) production companies.

It is worth noting, in particular, that by using the tax identification number (CIF), the parent entity collects finished products made through the activity carried out from the gate of its own factory, not just services.

The fragmentation of the production activity (purchases of raw materials, equipment under the held tax identification number, the performance of the contract-based labour within one’s own limited liability company) and transactions – exempt intra-Community supplies (the VAT code of the Member State) are one of the most aggressive methods of ‘aggressive’ tax optimisation allowing profit outsourcing, as shown, through successive intra-group transactions and the manipulation of the prices of these transactions.

4. THE IMPACT OF THE CJEU CASE C 333/20 – BERLIN CHEMIE

The recent CJEU case C 333/20 Berlin Chemie (<https://curia.europa.eu/juris/document/document.jsf?text=&docid=257485&pageIndex=0&dclang=RO&mode=lst&dir=&occ=first&part=1&cid=1119983>) decided on 7 April 2022 (Judgment of 7 April 2022, C-333/20 Berlin Chemie, EU:C:2022:291) brings clarifications on the economic activities carried out between subsidiaries (the wholly owned limited liability company – SRL) and the parent entity, in the sense that VAT cannot be collected for the activities of the limited liability company for the parent entity for services rendered – which also falls within CJEU guidelines prior to this ruling.

But what is particularly relevant in the statement of reasons of the CJEU is that for intra-group transactions (services) the parent entity has been shown to lack the ‘structure’ needed to receive services on a permanent basis.

- Taking into account the fact that the statement of reasons has shown that the parent entity uses the external resources (i.e. material and staff resources) existing at the wholly owned limited liability company – a fact also substantiated by the control body in the dispute before the Romanian court, the lack of structure of the parent entity in Romania does not allow the collection of VAT (as claimed by the tax body, although it wholly owns and controls the limited liability company). The error identified which follows from the statement of reasons in the case is that the tax body has not registered the ‘structure’ *ex officio*, although it has demonstrated the fulfilment of the conditions for the existence of a fixed establishment in terms of VAT. *Ex officio* registration involves the assignment of a tax identification number (CIF) – according to the Order no. 2921/12.10.2016 (Order no. 2921/12.10.2016 approving the Procedure for the tax registration, either *ex officio* or at the request of another authority managing tax claims, of a subject of tax law that has not fulfilled its obligation of registration for tax purposes, according to the law; the issuer: the Ministry of Public Finance – the National Agency for Fiscal Administration, published in: the Official Journal no. 850 of 26 October 2016).

The preparation and submission of the official report and the issuance of the decision for the *ex officio* registration of the fixed establishment (it uses the material and human resources which it controls (on the grounds that it uses the material and human resources it controls - it owns the limited liability company - it has a permanent activity resulting from the duration of the contract/order), it has a permanent character and a fixed place of business (at the owned limited liability company). It is worth noting that the conditions for the fixed establishment are met, but it should also be pointed out that the parent entity declares domestic and intra-Community supplies through a tax representative (the tax identification number held), so the tax body can ascertain that the activity of the parent entity is carried out at the establishment of the tax representative, and the same tax identification number should also be assigned for the fixed establishment. In fact, the tax representative is a fixed establishment of the parent entity, but as shown (a permanent character, profit obtained by making supplies) it is also a permanent establishment, since the activity and transactions prove in fact the realisation of profit.

The business fragmentation thus employed has allowed the avoidance of tax obligations in Romania. Since the transactions are related party transactions, without economic substance – in fact they are a cross-border arrangement (Art. 286(t) of the Law no. 207/2015 on the Tax Procedure Code; 01/07/2020 – the point was added by Ordinance no. 5/2020) through which tax advantages (Guide on the obligation to report cross-border arrangements (EU Directive

2018/822 – DAC 6), 2021, www.anaf.ro) are obtained by the parent entity for the activity carried out in Romania:

1. The provisions of art. 11(1) of the Law no. 227/2015 on the Tax Code are applicable:
“Tax authorities may disregard a transaction that does not serve an economic purpose, in determining the amount of a tax or a compulsory social contribution, adjusting its tax effects, or may re-classify the form of a transaction/activity to reflect the economic content of such transaction/activity.”
2. The entities (the limited liability company – SRL and the group) are required to report cross-border arrangements aimed at avoiding tax obligations (corporate tax, VAT); otherwise, they are subject to a fine (art. 286 – 291 of the Law no. 207/2015 on the Tax Procedure Code and the Government Ordinance no. 5/28 January 2020 amending and supplementing the Law no. 207/2015 on the Tax Procedure Code).

In this regard, the recommendations of the European Commission of 6 December 2012 (Aggressive Tax Planning – the European Commission in Recommendations on aggressive tax planning (2012) defines this phrase as an advantage obtained as a result of legislative details of a tax system or discrepancies between two or more tax systems, in order to reduce the tax obligations of the DAC 6 Guide) on aggressive tax planning stated that: “An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.”

These artificial arrangements are not subject to double taxation conventions, either.

5. THE APPLICATION OF THE MULTILATERAL CONVENTION (MLI) IN ROMANIA

In January of 2022 Romania ratified the Multilateral Convention and notified the implementation of review measures concerning:

- The permanent establishment – *it would no longer be possible to fragment the activity by interposing another group entity;*
- *The economic substance of transactions* – treaties do not apply to artificial transactions;
- *The exclusive use of the tax credit method* (the exemption method is waived in order to eliminate double taxation).

Thus, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – MLI, the latest rulings of the CJEU (see Cases: C 333/20 *Berlin Chemie*, C 98/21 *Finanzamt R*), EU Directive 1164/2016 (Art. 6 of Directive 1164/2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market – General anti-abuse rule), the DAC 6 Directive (Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements) are sufficient tools and offer applicable/relevant legislative ‘remedies’, depending on the case, to allow the reconsideration in intra-group transactions of the economic activity carried out in Romania and the reinstatement of tax obligations similar to ‘independent’ persons, i.e. at market price.

The influence of a reconsideration of the activity/transactions between group members can be substantial/significant, and, so, it is necessary to change the business model in order to comply with applicable legal provisions. Following a tax inspection, the consequences can be significant for both the activity and the image of the entire group of multinational enterprises.

6. CONCLUSIONS – FUTURE DEVELOPMENTS IN THE TAX POLICY

In view of the fact that the European Commission is preparing amendments to Directive 2011/16/EU (ATAD III) in order to identify entities without economic substance (shell companies) and to reinstate artificial transactions for taxation purposes in the near future, it is the tax inspectors' responsibility to review, ascertain and substantiate the entire (rather than fragmented) state of affairs in terms of tax for the taxpayer, and it is the taxpayers' responsibility to justify the economic substance of the transactions.

This requires the establishment of inspection procedures and procedures for reconsidering/reinstating transactions in a transparent way, as approved by the business environment, as well as adequate remuneration for the staff involved in such complex activities, accompanied by legal protection for the civil servants exercising powers of authority of the Romanian state.

Romania's notifications and proposals regarding the application of the provisions of the Multilateral Convention (MLI) will have a major impact on implemented business models and require their re-examination in the case of aggressive tax optimisation (which uses cross-border arrangements in order to obtain tax advantages). Otherwise, companies will expose themselves to tax inspections based on transfer pricing risk analyses – as a result of successive related party transactions.

The reconsideration of transactions or of the reclassification/reinstatement of the economic activity carried out in Romania by multinational companies due to the failure to declare the permanent establishment (in terms of corporation tax) or the fixed establishment (in terms of VAT) to the competent tax body can have significant effects in terms of both the amount of the tax obligations established as a result of tax inspections, and the reputation and image on the multinational company.

Disputes between tax authorities and foreign entities that aggressively optimise and plan their business with the aim of avoiding tax obligations can be eliminated by creating a stable business environment that fairly pays its tax

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USING PROJECT MANAGEMENT IN THE IMPLEMENTATION OF PROJECTS WITH NON-REIMBURSEMENT FUNDING

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ABSTRACT: *Projects with non-reimbursable financing have an important role in the economic and social development of Romania, constituting a way of accessing external assistance. The needs to adjust the legislative and methodological basis for a successful implementation of the projects are becoming more and more felt. Non-reimbursable financing aims to support the carrying out of activities that are important for certain segments of society or for the overall development of the economic body and social, in areas for which, due to the economic situation, there are not enough accessible financial resources (for example, infrastructure rehabilitation in poor regions, professional retraining, support for the development of the NGO sector as a partner of public authorities) or areas where traditionally there are a need for financial resources greater than availability (eg social activities). Most financing of this type is granted to Romania by other states or international institutions, the Romanian society being in the middle of a process of social change, of modification of social and economic structures, as well as mentalities, collective representations, social practices, styles behavioral. The grant system is one of the components of the wider mechanisms of collaboration between different states, having the character of aid granted to support the solution of exceptional situations in which the state receiving this aid does not have the expertise or the human and material resources necessary to try to themselves an effective solution. For this reason, the actual financial resources are accompanied by a whole specific methodology that must be respected in the process of granting financing and through which certain elements of social philosophy are implemented that have proven their validity in similar situations encountered both in Romania and in other states.*

Keywords: *European funds, project management, project implementation, grant funding, strategic objectives, organizations, operational program*

JEL Classification: *H43, M21*

1. INTRODUCTION

In recent years, more and more organizations have had the chance to start the realization and implementation of projects with non-reimbursable financing. However, with the start of the projects, the first difficulties and obstacles appeared, of a technical, social and especially financial nature. Romania's accession to the European Union in 2007 meant the orientation towards a new stage of socio-political and economic development, but this came on the ground of an accentuated economic crisis, with an unprepared society but still eager to develop, to modernize to the standards of the other member states. In order to reach this goal, Romania had and has at its disposal sources of financing from European funds, which should, under the conditions of good project management, contribute to eliminating the gaps in society and the gaps between our country and the other member states of European Union.

European funds are the financial instruments, the only ones, moreover, which should ensure the sustainability of public and private budgets and contribute to the progress of society and the growth of investments in the private sector, thus ensuring stability and real economic progress. Accessing and using European funds in the public and private sector should ensure a

share of 3.5-4.5% of Romania's GDP, a fact that would generate a balanced development of Romanian society, which would translate into an increase in the level livelihood and in increasing the skills of the human resource.

The modernization of Romania in the Multiannual Financial Framework 2007-2013 was difficult, blocked in particular in the poor access to European funds and this due to the lack of a vision of efficient management, confined especially to the bureaucracy, a late legislative framework, cumbersome procedures and very long deadlines response, both from the beneficiaries, and especially from the Management Authorities and Intermediate Bodies. In other words, from the funds made available to Romania from the European Union budget, in the period 2007-2013 the percentage of absorption was quite low, of approximately 70% according to the situation presented by the Ministry of European Funds in February 2016. However, in the Multiannual Financial Framework 2014 – 2020, Romania has streamlined the institutional and regulatory framework (HG 398/2015) in order to increase the level of absorption of European funds, the total allocation from the European Union budget for our country being approximately 43 billion euros, of which 22.9 billion for the Cohesion Policy and 20 billion for the Common Agricultural Policy and the Integrated Maritime Policy. In addition to the efforts made by the Authorities to make the absorption process more efficient, by developing an easy legislative framework, synchronizing national plans and strategies with European objectives and the Europe 2020 strategy, some tools for implementation and real-time monitoring of the evolution of European-funded projects (example MySMIS2014+ platform), the beneficiaries are the ones who should take care of the good management of funds by adopting modern management systems, based on easy procedures, with rigorous risk management and human resource management based on expertise and leadership. On April 14, 2022, Romania concluded the partnership agreement with the European Commission regarding the Multiannual Financial Framework 2021-2027 and future financing programs. Thus, in the next period, our country is to obtain European funds of over EUR 100 billion, of which EUR 79.9 billion represent non-reimbursable sources of financing allocated to the 9 operational programs in the major areas of the economy, as well as a budget of approximately EUR 20 billion allocated to the agricultural sector. From the total budget approved by the EU, i.e. EUR 1.074 billion, for the period 2021-2027, Romania obtained about 7.5% of the total, i.e. EUR 79.9 billion, which will be used in the form of an economic recovery package, for the development of the infrastructure in our country, the modernization and construction of new hospitals and schools, the restoration of public systems, as well as funds allocated for the improvement of the Romanian business environment in key areas.

The importance of adopting such management results from the need to manage at a higher level a proposal / a request for financing, which satisfies both the needs of the addressed target group (solving the problem through the established objectives), but which also ensures the sustainability of the investment over time, to ensure a major impact both for the beneficiaries and for the community.

2. CONTENT

The concept of the project has appeared since antiquity, the oldest projects are considered to be the pyramids of Ancient Egypt, built according to plans that still issue various theories today. It is certain that for the construction of the pyramids human resources were allocated both from the category of managers (supervisors of the activity) and from the category of execution personnel (free workers and slaves). The successful development and implementation of a project presupposes, first of all, familiarization of the individual with the term project, with a clear understanding of the project concept. In the specialized literature, several different definitions of the notion of project are highlighted, from which we note:

i) a collective creation organized in time and space (Giard V., Milder C., 1993); ii) an intention, which is marked by the uniqueness of the conditions in their totality such as: general purpose/objective, limited time period with start and end date, fixed budget, limited human resources, delimitations in relation to other intentions/needs, specific organization per project (Grossu, A., 2016); iii) a unique process that consists of a set of coordinated and controlled activities, with start and end dates, undertaken with the aim of achieving an objective in accordance with the requirements specific, including time, cost and resource restrictions (PMBOK Guide, 2004); iv) set of activities carried out and oriented towards the achievement of specific, clearly defined objectives, in a predetermined period of time and based on a dimensioned budget (Project Cycle Management Guidelines, 2004).

The specialized literature offers numerous opinions regarding the definition of the project. However, the definitions given to this concept all refer to a certain number of common characteristics that make it possible to identify the unique character of projects (Belout, A., & Gauvreau, C., 2004). In general, experts in the field agree to define the project as a series of complex and interdependent activities (Pinto, J. K., & Prescott, J. E., 1988), oriented towards one or more very specific objectives determined from the start using the given resources (human and material) (Genest, B. A., & Nguyen, T. H., 2002). Adams (1997) states that projects generally pursue one or more of the following four objectives: creating change; implementation of strategic plans; fulfillment of contractual commitments; solve specific problems (Adams, J., & Adams, J. R., 1997).

3. METHODOLOGY

From a methodological point of view, the following methods, tools and procedures were used: accumulations and results from national and international specialized literature and legislation. At the same time, the practical experience, analysis and statistics of the specialists in the explored field were also the basis for the realization of this scientific approach. The methodology used combined qualitative and quantitative research, through varied and complementary methods: historiography, documentary analysis and observation.

In order to substantiate the decisions regarding the relevance of the tools used in the process of implementing projects with non-reimbursable financing, we used our own data processing process, figures and tables, an impact analysis to highlight the results, efficiency, inconveniences and advantages obtained from the implementation of projects with Grant. Also, according to the statistics that were the basis of this analysis, as the author I took as a benchmark efficiency, as the main economic instrument, the rate of absorption of European funds in the EU, the amounts received by Romania for each Operational Program as well as the status of European funds in Romania 2022.

4. DISCUSSION AND RESULTS

A project is a set of unique, complex and connected actions that have a beginning, a middle and an end, having only one goal that must be completed within a certain time, based on a temporary effort undertaken to create a unique product or service, through a unique set of interconnected tasks and efficient use of resources. Project resources in this context could be in the form of financial support, human and technological resources.

An essential feature of the projects is that each one is unique. They vary in scope, objectives, delivery time, location, cost and customers. However, effective project management requires that each project have a well-defined objective, an effective budget, and a series of interrelated tasks (Schachter, D., 2004), inherent levels of risk and uncertainty (Watson, P., 2009)

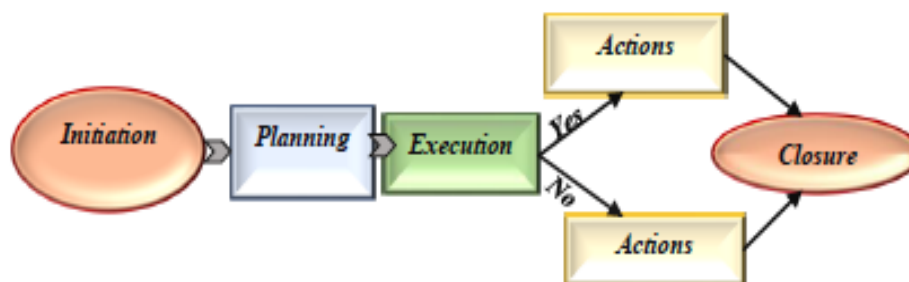
No organization can survive without the successful input of project management. Project management facilitates the change process and creates value (Bredillet, C., 2010), it is a key driver of business innovation and change that positions organizations to become more competitive (Shenhar, A. J., Milosevic, D., Dvir, D., & Thamhain, H., 2007) and improves project culture, efficiency and effectiveness (Artinsuo, M., Hensman, N., Artto, K., Kujala, J., & Jaafari, A., 2006). These changes range from integration to major business reorganization, the development of new initiatives between a company, its customers, suppliers and strategic partners.

Project management processes are organized into five basic Process Groups:

- ✓ Initiation processes are those processes executed to authorize and define the scope of a new project phase.
- ✓ Planning processes are those processes executed to define and elaborate in detail the scope of the project, to develop the Project Management Plan and to identify and plan the (project) activities that occur during the project.
- ✓ The execution processes are those processes executed to carry out the works defined in the Project Management Plan, in order to achieve the project objectives defined in the statement regarding the general scope of the project.
- ✓ The monitoring & control processes are those processes necessary to initiate, plan, execute and conclude a project with the achievement of performance objectives, defined in the Project Management Plan and in the statement regarding the general scope of the project.
- ✓ Closing processes are those processes executed to formally end all project or phase activities and transfer the finished product to others.

Each Process Group consists of one or more management processes. Process groups are linked by the output they produce - the output or output of one often becomes an input to another group (see figure no. 1).

Figure no. 1. Monitoring and Control Processes



Source: adapted from Şavga, G., & Şavga, L. (2022). Project scope management through PMBOK.

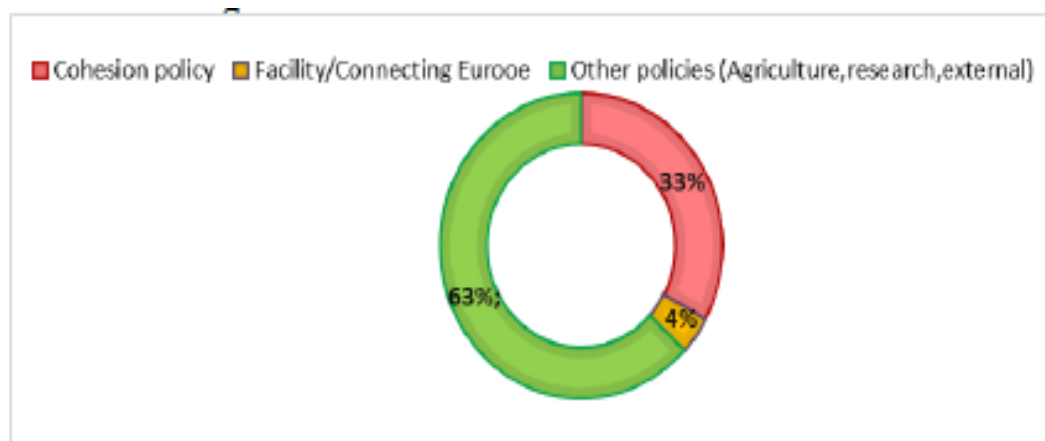
Romania's accession to the European Union raised a series of institutional, operational, procedural and sovereignty issues. Many specialists in the field asked themselves how "Can more funds be obtained from the EU?". The answer is provided by the regional and structural policy of the European Union. The European Union has set itself the goal of creating economic and social cohesion between member states, minimizing differences between levels of development, which ensures the prosperity of EU citizens, "reducing unemployment to negligible levels, uniformly developed regions, rural areas, realigning wages and of single

average pensions at the EU level". The declared objectives are implemented by the regional and structural policy of the EU through support and financing for development projects. The European Union annually contributes billions of euros to support member countries development programs and projects through the Structural Funds and the Cohesion Fund. Grants for development programs can be obtained through tenders.

All EU regions can benefit from ERDF and ESF funding. However, the Cohesion Fund can only support those countries where the gross national income (GNI) per capita is below 90% of the EU average. Romania, as an EU member state, receives resources through the Structural Funds, which aim to support underdeveloped areas. Structural funds are financial instruments, administered by the European Commission, whose purpose is to provide support at a structural level. Financial support from the Structural Funds is mainly intended for less developed regions, in order to strengthen economic and social cohesion in the European Union. The financing need of the Romanian economy in general is great and has few sources that can satisfy them considering the context and situation of the country. In my opinion and that of various specialists in the matter, the European cohesion funds can be a significant opportunity for the economic development of the country if they are well used. The variety of funds makes it possible to satisfy the needs of various sectors of the economy and different categories of public and private companies and institutions: some being intended for SMEs, others for large companies, others for local authorities, etc.

European funds are very important in the financing of public and private organizations from underdeveloped sectors, as Romania offers few sources of financing for them. For the 2014-2020 allocation period, the EU has proposed a budget of 1025 billion euros, with the following structure: 336 billion euros are intended for the 2014-2020 cohesion policy, 40 billion euros are intended for the Connecting Europe facility that finances cross-border projects energy, transport and information technology, and 649 billion goes to agriculture, research, foreign policy, etc. (See figure no.2).

Figure no. 2. Allocations of EU funds 2014-2020



Source: www.fonduri-ue.ro

The first experience related to the allocation of European funds in Romania was the preparatory one, in the sense that countries in the pre-accession period are granted funds to meet a series of macroeconomic indicators that will allow them to integrate into the EU.

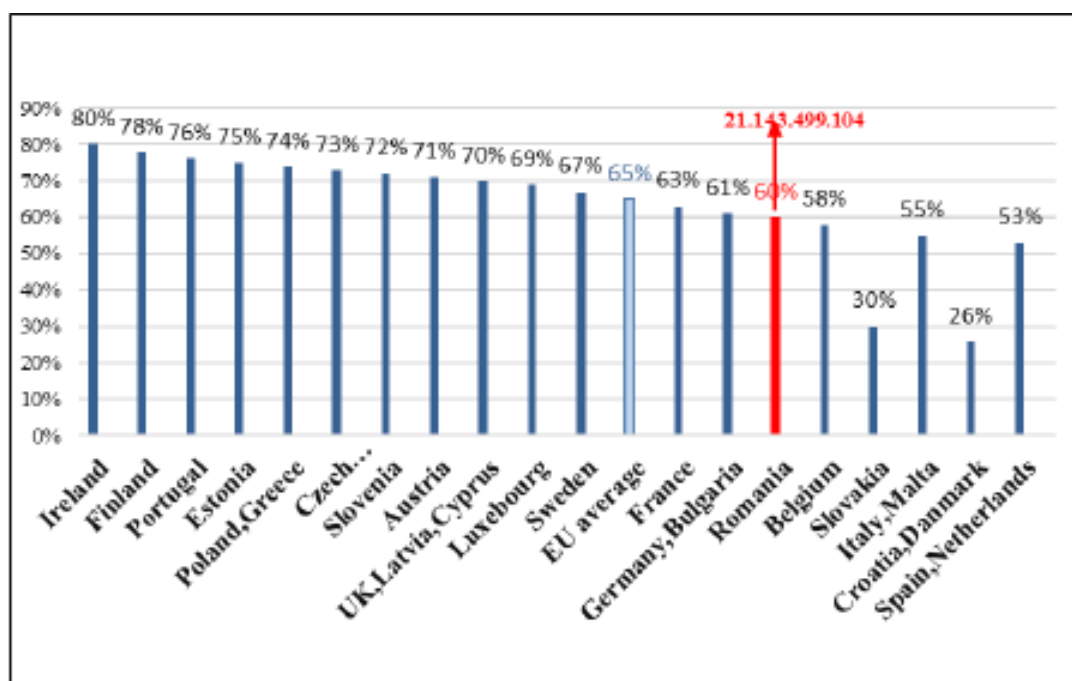
Thus, Romania benefited from the PHARE, ISPA and SAPARD funds as pre-accession funds, which had a sustainability period until 2009, when the first projects were started on the post-accession allocation. During the period 2000-2006, more than 600 civil servants worked

within these programs and were in charge of managing the funds, being employees of the ministries, their structures and state agencies. In the private sector, around 3,000 specialists (consultants, teachers, trainers, instructors, project managers, co-opted experts) worked with a preference for the PHARE program, the other programs being implemented without project employees.

The ISPA program was implemented with civil servants and the SAPARD program was mostly intended for the purchase of equipment. During this period, Law no. 490/2004 was also approved, which regulates the remuneration of personnel who have duties in the process of managing non-reimbursable community financial assistance or who carry out adjacent activities, of a financial-accounting or legal nature, contributing to increases of up to 75 % of the amount of basic salaries.

This was a motivational tool for civil servants, which contributed to increasing the degree of attraction of funds. Regarding the situation of the European funds obtained by Romania in the period 2014-May 2022, the absorption rate is 60%, the average at the level of the EU member states being 65% (See figure no. 3).

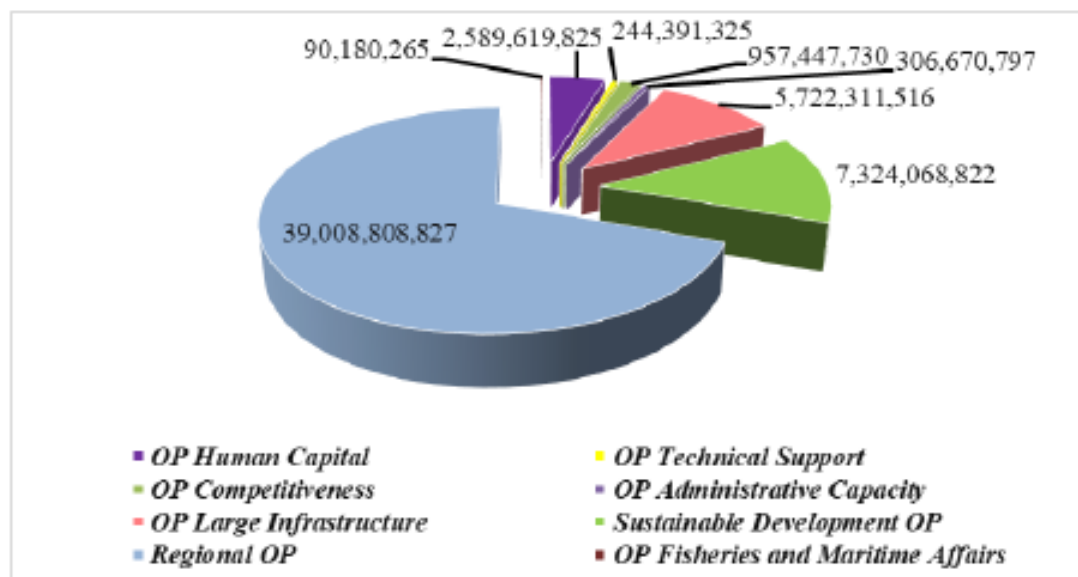
Figure no. 3. Absorption rate of European funds in the EU



Source: <https://mfe.gov.ro/situatia-fondurilor-europene-2-mai/>

21.14 billion euros entered Romania through the Cohesion Policy and the Agricultural Policy. In addition to this value, the sum of 12.39 billion euros was redirected directly to Romanian farmers. Thus, the total value of the signed financing contracts is approximately 73.40 billion euros, of which the total value of the open financing lines, representing 148.5% of Romania's total allocation.

Romania, through 8 national programs, benefited from EU funding in the amount of EUR 35.3 billion within the ESI programs 2014-2020 (from January 2022). This represented an average of €1,770 per person in the 2014 population.

Figure no. 4. The amounts received by Romania for each Operational Program in euros

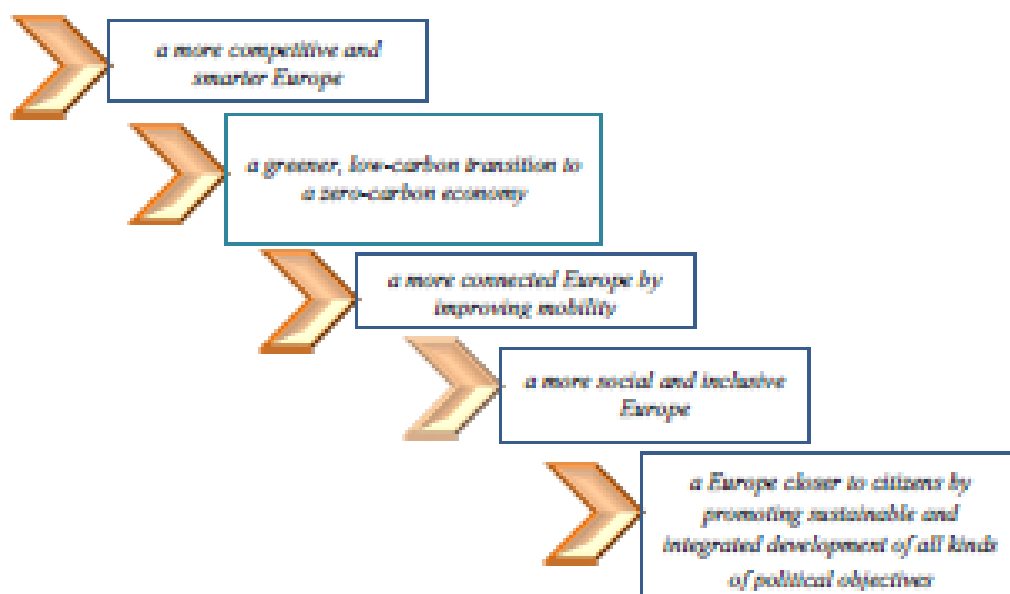
Source: projection made by the author

In the 2021-2027 financial program, Romania will receive more than twice the amount obtained in the period 2014-2020, which means that Romanian companies will have more financing available for their own needs, such as modernization and digitalization, but also for the development of infrastructure works in order to increase energy efficiency, the construction or modernization of schools, kindergartens, the rehabilitation of existing roads, the construction of new highways, bridges, the construction of hospitals at the national or county level, investments that will contribute to the development of the well-being of Romanian citizens. In this sense, the Government of Romania announced the availability of an additional budget of around 20 billion euros in non-reimbursable funds for the agricultural sector. During the 2021-2027 funding period, companies will be able to apply for funds directly from regional development agencies.

As the new multiannual financial framework for the period 2021-2027 proposes to modernize the cohesion policy and change it into a simple and flexible policy, simplification and the introduction of new flexibility tools are envisaged to facilitate the final beneficiaries of the funds. Through the Regional Operational Programs, the eight development regions of Romania will receive funding from European funds and funds from the local budget, to ensure the continuity of the strategic vision of sustainable and balanced development of the regions in the period 2014-2020, based on the directions, the actions and priorities of the Regional Development Plan 2021-2027 and the Smart Specialization Strategy 2021-2027, including the recommendations of the European Commission made in the 2019 country report on Romania. In addition to the 80 billion euros of non-refundable funds available to Romania, the European Commission's proposal for the 2021-2027 multiannual financial framework for the common agricultural policy amounts to approximately 20.5 billion euros.

In the 2021-2027 period, the EU's cohesion policy set out a shorter and more modern menu of 5 growth-supporting policy objectives for the period 2021-2027.

Figure no. 5. The political objectives regarding the development of Europe for the period 2021 – 2027



5. CONCLUSIONS

Anchoring in the reality of the absorption of European funds at the level of Romania is, as can be seen, a long-term and rather difficult process. The level of the absorption rate is still low in our country, the recorded average being only 63.72% below the average of the EU member states. As of July 2022, Romania has contracted a number of 9,682 projects, with budgets totaling EUR 35.43 billion and total eligible expenditures of EUR 34.47 billion. The EC co-financing is EUR 28.06 billion and the national contribution is EUR 2.75 billion.

EU funds can be obtained through tenders, one condition of which is consistency with the policies and objectives of the European Union. In addition, the ways and means of winning tenders should be recognized.

In addition to technical knowledge (preparation of the tender request) and specialist knowledge (EU legislation, objectives, etc.) less specific but important skills are needed such as: i) finding partnerships (to ensure the widest socio-economic participation possible in the project); ii) programming (compliance with the regulatory process of implementing EU support objectives); iii) additionality (refers to the complementarity of subsidies); iv) co-financing (own funds); v) concentration (funds can be used for limited purposes) and vi) compatibility (coherence of the objectives of the Union and of the funds).

Romania is a developing country and is in great need of European funds for economic development. The data related to the absorption rate of European funds in Romania are not very positive data, but rather worrying data for the Romanian economy, which is in such great need of the financial support granted by the European Union through the structural funds. There are several elements that prevent the absorption of funds European in Romania. For example, bureaucracy, lack of resources for co-financing, corruption, lack of information, delays in receiving payment once the contract is signed, etc.

Despite all these inconveniences, European Union funds are an opportunity for our country to recover socio-economic disparities and be as competitive as other EU countries. As a result of the implementation of European funds, both pre-accession and post-accession, the number of public and private national organizations experienced a very positive evolution in Romania. The number of organizations that benefited from European funds increased constantly during the pre-accession period and continued with the same trend in the post-accession period, except for 2009, when the international economic crisis was also felt by our country.

In addition to the positive impact on the evolution of national organizations, other results produced by the implementation of European funds can be highlighted, such as: the positive evolution of GDP (although small), the increase in production, the increase in employment and the decrease in unemployment, all thanks to the creation of new organizations partially financed by European funds. The following diagram illustrates how access to European funds contributes to the development of the economy in general due to the influence it has on the main economic indicators.

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